Ontario

Municipal Capital Budgeting Handbook

SPRING 2000

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and Housing

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Ontario

March 2000

Heads of Council

I am pleased to introduce you to the inaugural edition of the Capital Budgeting Handbook. This handbook with accompanying software is designed to assist you in developing a structured approach to capital budgeting and planning within your municipality.

The handbook and software are the result of a unique, joint project developed by a committee with representatives from the Ministry of Municipal Affairs and Housing, including staff from the Municipal Finance Branch, the Municipal Support Services Branch as well as various Municipal Services Offices. Also included on the committee were representatives from several municipalities, as well as representatives from the Association of Municipal Managers, Clerks and Treasurers of Ontario (AMCTO), the Municipal Finance Officers' Association of Ontario (MFOA) and the Canadian Institute of Chartered Accountants (CICA).

We are committed to helping municipalities to be efficient, effective, and accountable to the taxpayer. I believe the Capital Budgeting Handbook serves this purpose well, as it was developed to assist municipalities in determining their capital requirements. With the realignment of local services, capital budgeting is becoming an increasingly important component of planning, financing and managing municipal capital infrastructure. We recognize that some of you may already have developed your own capital budgeting systems and that it can be difficult to initiate these processes, especially in smaller and mid-sized municipalities where there are competing demands. The handbook and software were designed with this in mind. We welcome your feedback and will work collectively with AMCTO and MFOA to continually enhance the tool.

Heads of Council

Training sessions will be offered by AMCTO and the MFOA in the spring to help you use this handbook and produce capital budgeting documents for both short and long-term purposes. Information on these sessions can be obtained from the AMCTO and MFOA web sites: <www.amcto.com> and <www.mfoa.on.ca>. In addition, ministry staff from our Municipal Services Offices will provide any additional help you may need.

The Capital Budgeting Handbook can be found on our website: <www.mah.gov.on.ca>. Copies will also be available during the training sessions and from Municipal Services Offices.

I certainly hope you find this handbook useful in helping you to plan for the continued success and growth of your municipality.

Yours very truly,

Tony Clement
Minister

c: CAOS/Treasurers
Municipal Clerks

Ontario

Municipal Capital Budgeting Handbook

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Disclaimer

The Ministry of Municipal Affairs and Housing believes that the Municipal Capital Budgeting Handbook material may be helpful to municipal users. However, the Handbook deals with complex matters and may not apply or take into account particular or local facts and circumstances. As well the Handbook reflects laws and practices which are subject to change. Municipalities are responsible for making local decisions, including compliance with any applicable statutes or regulations. For these reasons, the Handbook should not be relied upon as a substitute for specialized legal or professional advice in connection with any particular matter. The user is solely responsible for any use or application of the Handbook.

Although the Handbook has been carefully prepared, the Ministry does not accept any legal responsibility for the contents of the Handbook or for any consequences, including direct or indirect liability, arising from its use.

TABLE OF CONTENTS

Page

Acknowledgments (i)

1. Introduction ... 1
    - 1.1 Introduction ... 1
    - 1.2 Overview of the Municipal Financial System ... 2
    - 1.3 What is a Capital Budget? ... 5
    - 1.4 Definition of Capital Expenditure ... 5
    - 1.5 Purpose and Who Uses the Capital Budget ... 9

2. Capital Budget Process ... 12
    - 2.1 Overview of the Process ... 12
    - 2.2 Policies to Guide the Process ... 21

3. Capital Financing Alternatives ... 24
    - 3.1 Summary of Capital Financing Alternatives ... 24
    - 3.2 Internal Financing ... 24
    - 3.3 External Financing ... 28
        - 3.3.1 Development Charges Act, 1997 (Bill 98) ... 29
        - 3.3.2 Municipal Act ... 31
        - 3.3.3 Local Improvement Act ... 32
        - 3.3.4 Municipal Act, Section 210 - Innovative Financing ... 32
        - 3.3.5 Bill 26, *Savings and Restructuring Act, 1996* ... 34
        - 3.3.6 Capital Reserve Funds ... 36

4. Capital Budget Documentation ... 37
    - 4.1 Overview of Documents ... 37
    - 4.2 Capital Budget Detail ... 39
    - 4.3 High Level Budget Summaries ... 48

4.4 Specialized Reports 49

5. Debt Management 63
5.1 Overview 63
5.2 Guidelines - Annual Repayment Limit Calculation 64
5.3 Debt Management - Long-Term Debt vs. Pay-As-You-Go 70

6. Long Term Impact 73

7. Capital Budget Maintenance 78
7.1 Work-in-Progress Monitoring 78
7.2 Closure of Completed Projects 79
7.3 Financial Reporting/Audit Requirements 80

8. CONCLUDING REMARKS 82

APPENDIX A

Glossary of Terms 83

APPENDIX B

Examples of Forms, Reports, Processes and Policies Used by Ontario Municipalities 86

APPENDIX C

Ontario Regulation 799/94 Debt and Financial Obligations Limits 87

APPENDIX D

RESERVES, RESERVE FUNDS, ALLOWANCES, TRUST FUNDS AND OTHER SPECIAL FUNDS, MINISTRY OF MUNICIPAL AFFAIRS AND HOUSING, JULY 1995 93

APPENDIX A

LEGISLATION COVERING OBLIGATORY RESERVE FUNDS 107

APPENDIX B

LEGISLATION COVERING DISCRETIONARY RESERVES AND RESERVE FUNDS 113

APPENDIX E

A Sample of 2000 Financial Information Return Schedules (proposed format for information only) 119

APPENDIX F

Other Publications and Sources of Material on Capital Budgeting and Capital Financing 128

APPENDIX G

Instructions for Capital Budgeting Application Software Set-up and Use .. 130

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1. INTRODUCTION

1. INTRODUCTION

1.1 INTRODUCTION

As of mid-1999, there were 586 municipalities in Ontario that spend approximately $4 billion annually on capital projects. It is anticipated that this spending amount will grow as municipalities take on their new responsibilities under the Provincial Local Services Realignment (LSR) initiatives and other transfers such as highways. LSR has highlighted the need for municipalities to plan and budget for their capital works programs in a strategic manner.

Capital budgeting is a very important planning tool for municipalities as it allows them to provide for the necessary infrastructure to maintain or enhance future service levels. Through capital budgeting, municipalities can plan future operating budget expenditure, debt repayment and potential reserve fund needs in order to manage the financial position of a municipality over a five to ten-year period. Capital budgets provide the basis for the implementation of official plans, master plans and strategic plans and also provide the financial mechanism to implement Council's planning and fiscal policies.

The purpose of this manual is to assist municipalities in the development of their capital infrastructure planning and budgeting processes. The manual recognizes the increasing need on the part of municipalities to prioritize various competing capital requirements and the application of scarce financial resources to those needs. It is important that municipalities have the tools available to them in order to project the financial impacts of their decisions over a number of fiscal periods.

This manual is specifically targeted to small and medium-sized municipalities. Larger municipalities will find that the principles and approach are similar to those applicable to them, although the process for review and implementation may differ. It is recognized that each municipal organization has unique characteristics, organizational structures, physical environments and financial resources, hence the principles and processes provided herein should be reviewed and adjusted to individualize them to each municipality.

Recently there have been many changes to municipal legislation and financial reporting procedures. Further changes may be made in the future which could affect aspects of this document. It is, therefore, recommended that provincial legislation and reporting requirements continue to be monitored as part of the municipality's ongoing capital budgeting process.

1.2 OVERVIEW OF THE MUNICIPAL FINANCIAL SYSTEM

Municipalities in Ontario use Fund Accounting as the basis for recording and reporting of all financial transactions. Fund Accounting can be defined as an "accounting system in which a self-balancing group of accounts is provided for each accounting entity established by legal, contractual, or voluntary action, especially in government units". In more simple terms, Ontario municipalities practice a form of accounting which uses three funds: a revenue (or operating) fund, a capital fund and a reserve fund. Each of these funds has a specific defined use; within that use, expenditures are financed by various sources. The three funds are described as follows:

Revenue Fund

The revenue fund or the "operating" or "general fund" as it is often called, is the principal fund found in all municipalities. This is the fund into which the main sources of financing available to the municipality flow. Taxation revenue, grants, interest earned on investments, service charges, licenses and permits are all recorded in this fund. This fund also records the everyday operating expenditures of the municipality. The revenue fund initially records most of the sources of financing that are eventually transferred to the capital fund and the reserve funds.

Capital Fund

The capital fund is used to record the financing sources and expenditures for the acquisition, rehabilitation or replacement of the capital assets of the municipality. In general, capital assets refer to buildings, equipment and infrastructure of the municipality. Included here are municipal buildings, arenas, trucks, graders, roads, water/sewerage systems and the like.

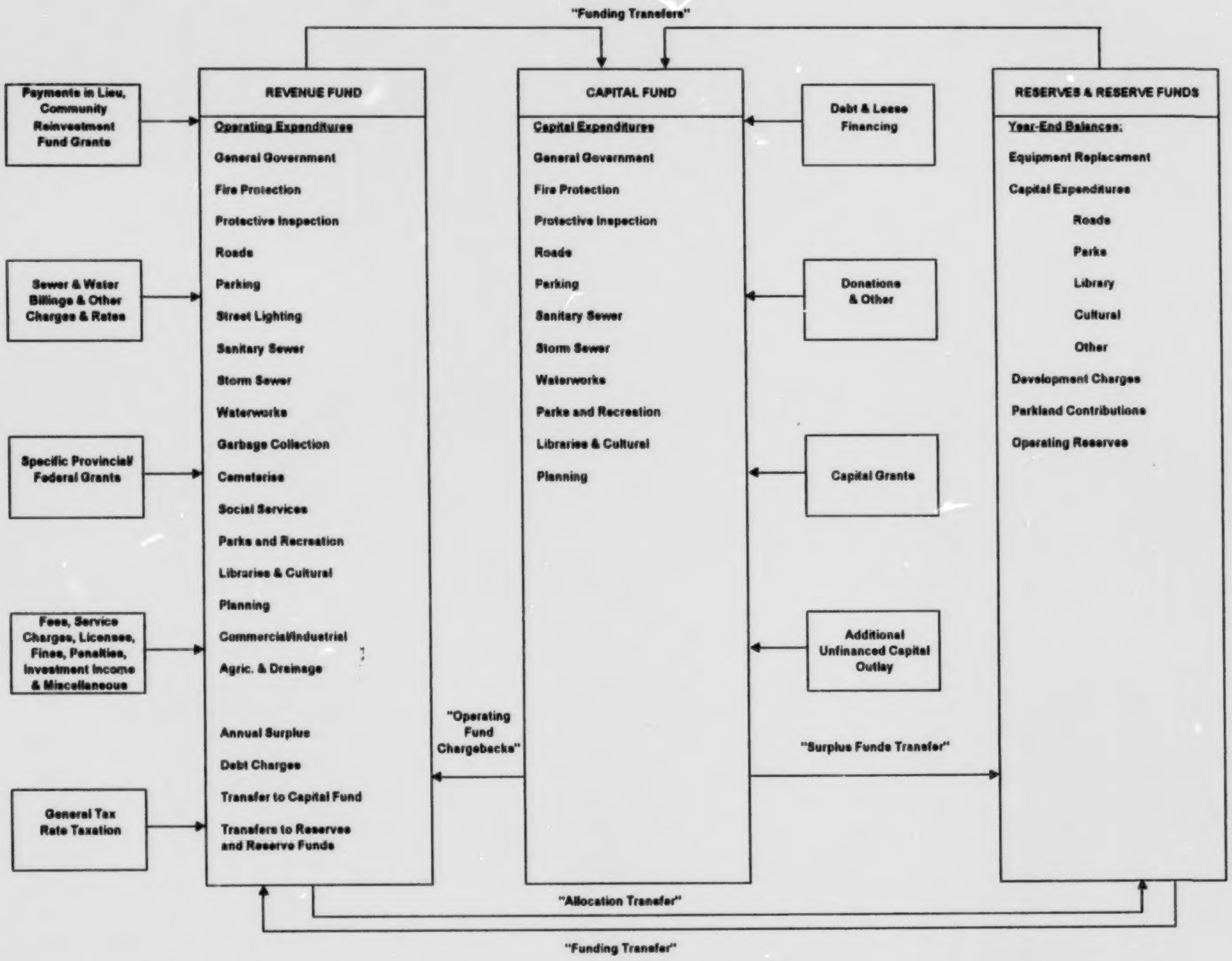
Reserve Funds

Reserve funds are those funds that have been set aside either by a by-law of the council or by a requirement of provincial legislation to meet a future event. As a result, reserve funds could be called either "permissive", those set up by Council or "regulatory" (or obligatory), those set up by virtue of a requirement of a provincial statute. As a general principle, municipal Councils may set up reserve funds for any purpose for which they have the authority to spend money.

An overview of these three funds, how they inter-relate and the more common expenditures and revenues associated with each fund is provided in Figure 1-1. This document will focus on the capital fund. References to how this fund interacts with the other funds will also be addressed.

FIGURE 1-1

SCHEMATIC OVERVIEW OF THE 1999 (OWN PURPOSE) MUNICIPAL FINANCIAL SYSTEM


"Funding Transfers"
Payments in Lieu, Community Reinvestment Fund Grants
Sewer & Water Billings & Other Charges & Rates
Specific Provincial/ Federal Grants
Fees, Service Charges, Licenses, Fines, Penalties, Investment Income & Miscellaneous
General Tax Rate Taxation
REVENUE FUND
Operating Expenditures
General Government
Fire Protection
Protective Inspection
Roads
Parking
Street Lighting
Sanitary Sewer
Storm Sewer
Waterworks
Garbage Collection
Cemeteries
Social Services
Parks and Recreation
Libraries & Cultural
Planning
Commercial/Industrial
Agric. & Drainage
Annual Surplus
Debt Charges
Transfer to Capital Fund
Transfers to Reserves and Reserve Funds
"Operating Fund Chargebacks"
CAPITAL FUND
Capital Expenditures
General Government
Fire Protection
Protective Inspection
Roads
Parking
Sanitary Sewer
Storm Sewer
Waterworks
Parks and Recreation
Libraries & Cultural
Planning
Debt & Lease Financing
Donations & Other
Capital Grants
Additional Unfinanced Capital Outlay
"Surplus Funds Transfer"
RESERVES & RESERVE FUNDS
Year-End Balances:
Equipment Replacement
Capital Expenditures
Roads
Parks
Library
Cultural
Other
Development Charges
Parkland Contributions
Operating Reserves
"Allocation Transfer"
"Funding Transfer"

1.3 WHAT IS A CAPITAL BUDGET?

A capital budget is a multi-year financial plan, usually five or ten years, for the construction or acquisition of capital works. The plan, once complete, should provide for the planning of future financial resources required to finance the project, identify the future financial resources to be allocated from the operating (revenue fund) budget to operate and maintain the capital asset once it is acquired, and integrate with the municipality's ongoing management control system.

The capital budget is distinguished from an operating budget. An operating budget normally provides for the day to day expenditures of a municipality for items such as salaries, wages, benefits, heat, hydro, maintenance of buildings and infrastructure, etc., whereas the capital budget plans for the acquisition or rehabilitation of capital assets.

1.4 DEFINITION OF CAPITAL EXPENDITURE

The manner in which the term capital is interpreted and applied for municipal purposes tends to vary from municipality to municipality. Many expenditures cannot be easily classified as capital or operating as they may display characteristics of both. Deciding what is capital is a matter of judgement and may be difficult in some cases. Accordingly, where appropriate a municipality may wish to seek professional advice. However, for general reference purposes, a number of definitions of capital found from several sources are provided below.

The Province is presently reviewing the definition of capital and may provide further instructions to municipalities with the 2000 Financial Information Return packages. This new definition would take into account the Public Sector Accounting Board (PSAB) rules respecting capital.

In the document, ***"Instructions for Completing the 1998 Financial Information Return"***, the following definition of capital expenditure is provided:

> "A capital expenditure is any significant expenditure incurred to acquire or improve land, buildings, engineering structures, machinery and equipment. It normally confers a benefit lasting beyond one year and results in the acquisition or extension of the life of a fixed asset. It includes vehicles, office furniture and

> equipment. An expenditure on repair or maintenance designed to maintain an asset in its original state is not a capital expenditure. A capital expenditure may include the costs of studies, etc., undertaken in connection with acquiring land or constructing buildings. It may also include interest on temporary borrowings for capital purposes and transfers for capital purposes to unconsolidated local entities, hospitals, universities and similar organizations."

The *Development Charges Act, 1997* (section 5(3)) provides a similar definition:

> "The following are capital costs .... if they are incurred or proposed to be incurred by a municipality or a local board directly or by others on behalf of, and as authorized by, a municipality or local board:
>
> 1. Costs to acquire land or an interest in land, including a leasehold interest.
>
> 2. Costs to improve land.
>
> 3. Costs to acquire, lease, construct or improve buildings and structures.
>
> 4. Costs to acquire, lease, construct or improve facilities including,
>
>   i. rolling stock with an estimated useful life of seven years or more,
>
>   ii. furniture and equipment, other than computer equipment, and
>
>   iii. materials acquired for circulation, reference or information purposes by a library board as defined in the *Public Libraries Act*.
>
> 5. Costs to undertake studies in connection with any of the matters referred to in paragraphs 1 to 4.
>
> 6. Costs of the development charge background study ...
>
> 7. Interest on money borrowed to pay for costs described in paragraphs 1 to 4."

The Public Sector Accounting Board (PSAB) may provide an authoritative guide for Municipal Reporting requirements at some time in the future. The Canadian Institute of Chartered Accountants (CICA) ***"Public Sector Accounting Recommendations - September, 1997"*** document provides the following definitions:

> "**Tangible capital assets** are non-financial assets having physical substance that are acquired, constructed or developed and:
>
> (i) are held for use in the production or supply of goods and services;
> (ii) have useful lives extending beyond an accounting period and are intended to be used on a continuing basis; and
> (iii) are not intended for sale in the ordinary course of operations.
>
> **Cost** is the amount of consideration given up to acquire, construct, develop or better a tangible capital asset, and includes all costs directly attributable to acquisition, construction, development, or betterment of the tangible capital asset, including installing the asset at the location and in the condition necessary for its intended use. The cost of a contributed tangible capital asset is considered to be equal to its fair value at the date of contribution."

In summary, from the above, capital works may be defined to include the following elements:

- acquisition and construction of new buildings, structures, facilities, equipment, rolling stock, furnishings, studies, development and purchase of land, and all associated items to bring the foregoing into function operation; or
- major rehabilitation of the above;
- normally has a useful life of more than one year.

For ease of administration, capital expenditures may have a minimum dollar amount associated with them (e.g. some municipalities define items in excess of $5,000 or $10,000 as a capital item). Figure 1-2 provides an informal comparison of capital asset expenditures versus expenditures which would typically be included in a municipality's operating budget.

FIGURE 1-2
SAMPLE GUIDE TO DISTINGUISHING CAPITAL BUDGET ITEMS FROM OPERATING BUDGET ITEMS

TYPE OF FACILITY	CAPITAL IMPROVEMENT	OPERATIONS AND MAINTENANCE
Streets and Parkways	• Street paving (residential and arterials) • Alley resurfacing • Physical alteration of street capacity or design, including related landscaping	• Paving repair, even though rideability may improve • Sealcoating and other maintenance
Sidewalks	• Sidewalk replacement, new sidewalks, sidewalk intersections	• Routine repair/patching
Traffic	• New or upgraded signal equipment or other physical improvements that enhance safety or system capabilities	• Equipment repair or replacement to maintain system operations • Lane marking and delineation • Meter replacement
Street light fixtures	• Conversion of street lights to new luminaries or fixtures	• Replacement or repair of damaged lights
Parking	• Major repair to structure • Physical design or capacity improvements • New construction • Computerized revenue control and other operating improvements	• Sealing floors to prevent chloride intrusion • Preventive maintenance and minor repair
Public buildings	• Major remodelling and structural alterations to improve space utilization or capacity • Major replacement or upgrading of design of major buildings components (roof replacement, major heating system improvements) • Energy-related physical improvement programs • New construction	• Preventive maintenance repairs that do not significantly upgrade the structure or increase its previously estimated useful life (e.g., minor roof repair)
Water treatment	• Rehabilitation of major treatment facility components (e.g., reservoir repair) to extend useful life • Reservoir connections, new sludge beds, other projects to upgrade treatment capacity, flexibility or quality • New construction	• General repair or maintenance of equipment or facilities to continue operations (e.g., wall and ceiling repair, cone motors and controls, sludge bed cleaning)
Water and sewer mains	• Large water mains (replacement) • Sewer separation (sewer modifications) • Flood prevention projects (sewer modifications) • Correction of low-pressure areas (small mains) • Other sewer or water main replacement in conjunction with street paving • Gates and manholes to improve system flexibility • New construction	• Repair of isolated section of broken or collapsed sewer or water mains, catch basins, sewer outlets, and repair fixtures as needed to maintain operations
Parks	• Boulevard reforestation • New park land development, major upgrading of park or park facilities, major park or park building rehabilitation • New park buildings • Physical improvements, lakeshore modifications or other facilities required for lake pollution control	• Removal of diseased trees from boulevards or parks • Repair or replacement of furnishings, equipment or landscape planting that do not substantially upgrade the park • General maintenance and repair of parks, park facilities and buildings

Excerpt from "Capital Improvement Programming - A Guide for Smaller Municipalities, GFOA, 1996"

1.5 Purpose and Who Uses the Capital Budget

Municipal multi-year capital forecasts can have widespread purposes and benefits. Many public and private sector groups may have an interest in reviewing these forecasts. An overview of various groups and potential use of the forecast is provided below:

Municipal Council:

To a municipal council, a capital budget represents a statement of intention to proceed with a certain program of capital works and services. Within specific programs, council establishes priorities for servicing and spending while controlling the ultimate impact on the tax/ratepayer over a five year (or longer) planning horizon. The budget also provides a control mechanism for future debt levels.

Council's input to the process is imperative as it will establish the direction the municipality will take over the short to medium term. Since the capital budget affects future operating expenditures, appropriate guidance should be provided during the capital budgeting process to ensure that desired service levels and tax levels are managed and planned.

In Ontario, the degree of council's involvement in the capital budgeting process varies from municipality to municipality. For example, councils may participate directly in the capital budgeting process, or they may establish policy direction and provide key input at various stages of the process. In each case, the council remains legally responsible for all budget decisions. Individual municipalities establish individualized processes to achieve local objectives. Council's involvement, in whatever form it may take, is important to the future financial health of the municipality.

Municipal Administration:

The capital budget represents an integrated and co-ordinated effort of the municipality and relies on inputs from several areas of municipal responsibility:

1. PUBLIC WORKS

Provides the analysis of needs, pre-planning and prioritization of services to be constructed in the future. With respect to ongoing construction of works, Public Works monitors quality control of the construction and expenditures within council-established spending limits.

2. FINANCE/TREASURY

To the Finance/Treasury department, the capital budget is a key financial planning document. From this document, Finance monitors existing and future debt levels, present and future impacts (debt charges and operating costs) on the operating budget and taxpayer rates, future grant applications, project monitoring, and budget control.

3. PLANNING

The capital budget represents a translation of planning policies and objectives into physical development plan. The Planning department reviews the projects in the capital budget to ascertain whether their implementation is in conformity with the Official Plan.

4. OTHER DEPARTMENTS

Other departments within the municipality (Fire, Police, Parks, Recreation, Library, Day Care, Homes for the Aged, etc.) also provide input into this document for the phased planning of their major works.

Upper/Lower Tier Government:

Both the upper tiers (regions, counties, and district) and lower tiers (City, Town, Township, Village, etc.) review each others' budget documents to ensure that certain works (eg. roads, water mains, sewer mains, etc.) can be co-ordinated with works planned by the other tier government. Cost savings can be achieved by undertaking certain works in a co-ordinated manner.

Provincial Government:

The Ministry of Municipal Affairs and Housing (MMAH) is the provincial ministry responsible for municipal issues. MMAH's vision for the municipal sector is that the sector should be more efficient, accountable and effective in addressing local needs. One of MMAH's key strategies is to work toward providing the Ministry and municipalities with opportunities to improve skills and tools to implement new responsibilities and directions, and to manage change. Also, the legislation administered by MMAH provides the primary governance and financial framework for local government.

MMAH's primary interest in developing a structured approach to capital budgeting is to facilitate informed decision making at the local level to meet capital needs. A sound capital budgeting system is part of an overall prudent and efficient financial management system that produces useful data and information.

MMAH often relies on the Financial Information Returns (FIR's) to obtain information and financial data for developing policies, programs or satisfying regulatory or statistical needs. The availability of information from capital budgets may provide useful and timely information on municipal capital needs.

Business Community:

The business community looks to the capital budget for an indication of the timing, location and types of services the municipality is planning to construct. Developers, or existing businesses, review this information to assist in their planning for development or potential expansion.

Financial Community:

The financial community reviews the capital budget to assess forward planning and future anticipated debt levels. Potential purchasers of municipal debentures are most concerned with the credit worthiness or risk involved in their purchase. More specifically, they are concerned with the municipality's future ability to pay their debt obligations.

2. CAPITAL BUDGET PROCESS

2. CAPITAL BUDGET PROCESS

2.1 OVERVIEW OF THE PROCESS

Like the operating budgeting process, the capital budgeting process consists of a co-ordinated inter-departmental process to establish a financing plan for the new construction, acquisition or replacement of municipal assets. These assets are normally an integral part of providing municipal services to constituents. However, since financial resources available to a municipality are limited, a process should be established to evaluate the competing needs of various municipal services in order to maximize the use of these financial resources in the area of highest priority to the municipality. To achieve this, a process should be put in place to involve all departments, senior staff and Council, in establishing management and financial policies and a system for prioritizing the capital works.

The capital budget is developed and given final approval at the same time as the operating budget. However, in some cases (ie. larger municipalities) the capital budgets may be finalized before the operating budgets. As noted in Chapter 1, the two budgets are inter-related and can affect one other. For example, the capital budget may require contributions to offset the need for debt, hence these contributions must be included in the operating budget. Alternatively, a major facility may be slated for completion mid-year and require an operating budget provision to pay for utility costs, staffing, and other operating costs. Therefore, the process should be aligned with the operating budget to ensure that proper consideration is given to the decisions being made in both budgets.

While the operating and capital budgets are inter-related, some municipalities do prefer to achieve a separation between the two processes. Having a capital budget approved very early in the cycle gives the municipality the advantage of being ready to tender projects early in the construction season, thereby achieving optimal tender prices. It also helps to spread the heavy workload associated with the budget process over a longer period of time, thereby achieving a more efficient use of staff resources. The capital budget can be separated from the operating budget cycle and approved in advance of the operating budget, if it is prepared within financial guidelines that are acceptable and have received the prior approval of Council. Council will only be in a position to approve the capital budget guidelines if the financial impact of those guidelines is known and understood in advance of actually providing final approval to the operating budget. This alternative process requires the ability to accurately analyse and project future financial impacts with reasonable reliability.

Figure 2-1 provides an overview of the capital budgeting process. The left side of the figure provides the sequencing of the actions to be undertaken in the process while the right side of the schedule provides a summary of the activity which occurs at that phase of the process. This process involves the following elements:

A. *Establish an Administrative Structure*

The preparation of the capital plan requires a co-ordinated approach by various departments within the municipality. It is, therefore, important that all user departments with capital needs be included in the process. Often in smaller municipalities, departments are represented by the department head. In larger municipalities, individuals within departments who normally identify and oversee the construction of the individual projects are to be involved. This co-ordination of effort may be achieved by establishing a committee. The overall function of the committee will be similar in either situation; however, the process outlined in Figure 2-1 may need to be modified to include the involvement of the municipality's senior staff or management team if this is appropriate to the situation.

Some municipalities also include the CAO/Administrator and may have individual council members sitting on the committee. Once again, the makeup of the committee is somewhat flexible and will reflect the way the municipality typically establishes its processes.

B. *Timelines/Policies*

The first order of the committee will be to establish timelines for carrying out the process. As noted earlier, the process should coincide with the operating budget process; however, most municipalities normally establish the capital budget process somewhat before the operating budget so that the identified impacts can be assessed and feedback to the capital budget can occur prior to either budget receiving final adoption. The timelines should also establish the critical dates for certain actions in the process (i.e. submission of project sheets, analysis preparation, review with committee/management team, council presentation, etc.).

The committee will also need to consider policies which will assist in developing the capital budget. These policies will include both management policies (which establish how the capital budget process on individual works are considered corporately) and financial policies (establishing the financial framework within which the capital budget will be prepared). These policies are discussed later in this chapter. In addition, the committee will need to consider a basis for prioritizing the projects. This prioritization is discussed further in Chapter 4.

Lastly, the committee should review the information to be submitted and how it will be provided. Sample forms outlining the key information which should be collected in this process are detailed in Chapter 4. Normally, the Finance/Treasury department is responsible for the preparation of the project sheet forms and analytical information to be used in this process. As well, they should be responsible for clarifying any questions raised by the user departments throughout the process.

C. *Review Work in Progress and New Capital Needs*

The user departments will be required to identify new capital needs for maintaining and enhancing their service provision. Identification of these needs can arise from many different sources, as follows:

- master plans
- strategic plans
- Official Plan
- community committee input
- service enhancement objectives
- council requests
- review of asset inventory (asset replacement)
- development servicing needs
- senior level of government initiatives
- emergency issues or directives from public health agency
- joint initiatives with other municipalities, agencies or community groups

While not an exhaustive list, the above represents the more common sources for identifying new capital projects. As the individual departments will be most knowledgeable of these potential needs, establishing the specific nature of the capital request is best defined by the user department. A representative within the municipality should be deemed responsible for administering requests made by outside boards or agencies.

In addition to new projects, existing projects, which have been approved by council and are being constructed, will also have to be reviewed. The key considerations in this review are the status of the emerging costs vs. approved budget and the timing of when expenditures are to be made during the remaining construction period. To assist in this evaluation, the Finance/Treasury department may wish to provide the most current expenditure and budget information to the user departments (if this isn't already part of the normal reporting process). User departments will be required to discuss the status of these works with the individual contractors to update the project completion information. This review is very important to the capital budgeting process since delayed projects or projects coming in under budget may free up financial resources. Alternatively, projects that experience cost overruns, if approved by council, will have first call on financial resources. Hence, it is important that this review be as accurate as possible.

D. Complete Capital Information Sheets

Often, it is easier to identify the need for an individual project than to estimate the expenditure budget. The capital information sheets presented in Chapter 4 provide the more common cost components of capital works; however, individual departments may still experience difficulty in developing a budget for a project. Listed below are several sources to contact in developing the budget estimates:

- cost estimates may be provided in master plans or needs assessments
- other municipalities which may have undertaken similar projects
- an architect or consultant specialist who assist in developing the project cost
- service associations
- construction cost manuals (e.g. Mean's)
- appraisers who can provide land value estimates

User departments should also provide information on project timing, future operating budget impacts, etc.. This is equally valuable as it provides additional information on which to evaluate and prioritize the project.

E. *Financial Evaluation*

The financial evaluation and assignment of project funding is to be carried out by the Finance/Treasury department. This evaluation would include funding alternatives for the individual works, debt requirements, cash flow implications, reserve fund draws and long term implications on tax and user rates. As part of this evaluation, summaries of expenditures by priority ranking and identification of expenditures which potentially exceed the financial policies established, is also undertaken. Much of this analysis is discussed further in Chapter 4.

F. *Committee/CAO Review*

Upon completion of the financial analysis, the committee should review the findings. If the capital requests are in excess of the municipality's financial capability, adjustments will be needed in order to ensure that it meets the management and financial policy framework established earlier in the process. The committee will need to review the individual needs of each project, its financial impact on the municipality, and its relative priority within the context of the total capital works requested.

It should be noted that this prioritization process is handled somewhat differently by different municipalities:

(1) Some municipalities will seek to develop the capital program, including each project and what year it is to be undertaken, at this committee level. In these cases, consensus is reached among user departments and a recommended program is put forth for council's consideration. Any projects which do not make it into the recommended budget are then listed as works which are outside of the planning period of the budget.

(2) In other municipalities, council may wish to participate in the evaluation process. Often workshops are established with council to review the information which would normally be part of the review undertaken by the capital budget committee.

How this process is undertaken is, to some extent, based upon the council operates. In the early stages of developing capital budgets, council may wish to be involved at greater depth until the process is well established. During this time, management and financial policies can be evaluated and fine tuned to a point where council members are comfortable with establishing the guidelines without participating in the detailed prioritization process. However, how the process is undertaken within individual municipalities is not as important as obtaining consensus both at the staff level and at the political level.

G. *Council Review, Input and Approval of Capital Program*

As noted above, the process of involving council may occur earlier in the process; however, most medium to large municipalities formally present a staff recommended capital program to council. A report needs to be prepared which communicates the following:

- approach to identifying and prioritizing projects
- summary of works in progress and the financial commitments made to date
- detailed listing of recommended capital programs
- summary of capital spending by service
- summary of capital spending by priority ranking
- summary of funding sources
- summary of debt amounts anticipated
- long term impact on tax and user rates
- listing of works which did not get included in the capital program

In presenting this information, each department often presents their individual works programs. This allows council to discuss specifics of individual projects. The capital program may be adjusted during this process and, if so, the evaluation schedules should be updated and provided to council for final approval. Often the capital budget is approved in principle until the operating budget process is complete. Both budgets are then formally adopted at the same time. It is noted that the current year's projects represent the works which will proceed; whereas, the year two and later projects represent a forecast and will be considered for actual approval to proceed in subsequent years.

H. *Implementation and Monitoring*

Upon completion of the capital budget, individual departments may proceed with the current year's approved works. These may include undertaking the design of the project, the purchase of land, initiating the tenders, etc. It should be noted that municipalities authorize and monitor ongoing projects somewhat differently. Some municipalities give staff the latitude to initiate and undertake the work once it is approved by council, as long as the project remains within the approved budget. Others provide for a staged approval process (e.g. initiate the design component, then land acquisition, then tender) which requires staff to report to council at key stages in the process. Either approach is acceptable; however, if the municipality has a large number of projects, the latter approach may be unnecessarily cumbersome to council.

To avoid using a staged approach, one method that may be used to reduce the need for review of individual projects is to implement status reporting to council by way of a quarterly report. This report would include "budget to actual" spending information, status of project timing, status of revenue collected or appropriated to the project, etc. Should any project budget need to be changed as a result of the estimate being too low for the project, council should be apprised of the need for a budget adjustment. In doing so, the source of the additional financing must also be approved to ensure that funding shortfalls do not occur. This may mean that additional reserve transfers may be needed, additional debt may need to be issued, or other projects may have to be delayed and revenue sources reallocated between projects. In all cases, this information must be presented to council for approval.

Similarly, once a project receives approval, staff should proceed to finalize external sources of funding. If grants, subsidies, or contributions from other external sources such as fund raising are required, the responsibility for following up on receipt of the revenue should be clearly assigned. Should it become apparent that an identified source of funding will not be attainable, reporting back to council will again be required. Council may, on occasion, approve certain works contingent upon being successful in obtaining external funding. Should those sources not materialize, council may need to delay or discontinue the project.

FIGURE 2-1

AN OVERVIEW OF THE CAPITAL BUDGETING PROCESS

ACTION	ACTIVITY
A. Establish Administrative Structure	• Establish a Committee consisting of CAO/Administrator, Department Heads, Key Line Staff and Council members
B. Establish Timelines/Policies	• Establish key dates and completion targets with Committee • Should coincide with operating budget process and be approved by Council • Establish management policies, financial policies and priority ranking parameters • Develop forms for collecting information
C. Review Work in Progress Projects and New Capital Needs	• Review status, timing and budgets of works approved and under construction • Consider inventory of existing infrastructure and assets (do they require replacement) • Identify new capital works
D. Complete Capital Information Forms	• Identify costs, timing, need, future operating impacts, etc.
E. Financial Evaluation	• Alternative capital funding, debt capacity, impact on operating budget, priority ranking, etc. • Evaluate affordability, priority ranking and provide summary evaluation to Committee

ACTION	ACTIVITY
F. Committee/CAO Review	• Evaluate program relative to financial/management policies and ranking criteria • Fine tune program and obtain consensus • Prepare report and recommendations to Council
G. Council Review Input and Approve Capital Program	• Presentation to Council for discussion and consideration
H. Implementation and Monitoring	• Initiate projects • Ongoing review of actual spending to budget, project timing, etc. • Pursue financing

2.2 POLICIES TO GUIDE THE PROCESS

A fundamental part of the capital budgeting process will be to establish policies to guide the capital budgeting process or to establish a financial framework within which the budget will be developed. Management policies are often developed to guide the ongoing capital budgeting process, whether it pertains to budget development or the ongoing work in progress. Financial policies establish the allocation of financial resources and limit the capital budget spending program to levels affordable to the municipality.

Development of policies are often specific to the individual municipalities and may differ significantly from one municipality to the next. Financial policies will often reflect the financial health or the financial management perspectives of the municipality, whereas management policies will reflect the management practices of council or senior staff. These policies should be discussed at both the senior staff levels and at council level to ensure consensus and conformity to those policies. Deviation from these policies could cause financial problems for the municipality.

A sample of management and financial policies employed by various Ontario municipalities is provided in Figure 2-2. These policies are provided as examples only and are not intended to represent "best practices" or as policies endorsed by the Ministry of Municipal Affairs and Housing.

FIGURE 2-2
SAMPLE OF MANAGEMENT AND FINANCIAL POLICIES

SAMPLE POLICY	POLICY OBJECTIVE
MANAGEMENT POLICIES	
"No capital project may be considered by Council which has not been identified in the Capital Budget"	Limits projects being presented on an ad hoc basis to council
"Projects which are initiated as part of a senior government initiative will not commence until funding is secured"	Ensures that projects initiated in whole or part by senior governments are not undertaken until specific funding is obtained
"No growth-related works will be undertaken without securing financing from benefiting landowners"	Similar to above, ensures land owner funding is in place before project is initiated
"No budget overruns are to be expensed until Council is informed and funding is allocated to project"	Ensures that Council approves any additional expenditures not approved
"Status reporting on capital works in project will be provided to Council on a quarterly basis"	Ensures ongoing status reporting is provided to Council
"No project expenditures within three years of project approval will require that the project be rebudgeted and approved by Council once again"	Ensures that the project undergoes a re-evaluation if the project has not proceeded in a timely fashion Ensures that project is still high priority when compared against other projects competing for funding
"x% of the capital expenditures will be set aside for health and safety matters and replacement of existing infrastructure"	Establishes the major priority for the spending of capital dollars

SAMPLE POLICY	POLICY OBJECTIVE
FINANCIAL POLICIES	
"The annual debt charges of the municipality shall not exceed x% of annual total own revenues"	Seeks to limit the amount of debt issued by municipality -- limits may be set below provincial guidelines to preserve some flexibility for emergency situations – policy may also limit the debt of individual programs
"Annual contributions for all capital purposes from the operating budget shall be x% of total operating revenues"	Seeks to establish an annual amount within the operating budget to be used exclusively for capital requirements. This policy could also be modified to establish a range of annual capital contributions by establishing minimum and maximum amounts. This policy provides an amount of available financing within which long term capital requirements may be prioritized.
"Any annual surplus in the operating fund shall be transferred to the unallocated capital reserve"	Seeks to build up reserves for capital purposes by setting aside one time surpluses for funding future capital works.
"Future operating expenditures allocated to the capital program for debt, contributions to capital and new operating expenditures arising from the capital program shall be limited to the growth in tax revenue associated with new assessment growth"	Seeks to allow future capital related operating expenditures to grow with new assessment growth.

3. CAPITAL FINANCING ALTERNATIVES

3. CAPITAL FINANCING ALTERNATIVES

3.1 SUMMARY OF CAPITAL FINANCING ALTERNATIVES

Sources of capital funding can be categorized into three main groups: internal sources, external sources, and debt or lease financing. Internal financing sources include to transfers from other municipal funds (i.e. operating or reserves) or sales of existing assets. External sources of financing include other government subsidies and grants (both federal and provincial), fundraising or donations, third party contributions under public/private partnership arrangements, etc. The third source, debt or lease financing, includes external borrowing and other long term repayment obligations.

Table 3-1 provides a summary of the various internal/external funding sources and provides an overview of the impacts of these financing sources on the operating and reserve funds along with an identification of who is affected by the use of these financing sources. This chapter will focus on internal and external financing while Chapter 5 will explain processes related to debenture/lease financing.

3.2 INTERNAL FINANCING

Internal financing is the transfers of funds from the current year operating budgets or existing reserves to assist in financing capital works. Some municipalities rely heavily on these sources as a way of eliminating or reducing their reliance on debt issuance. Successful use of internal funding, however, requires longer term planning and the use of policies to manage these resources in order to reduce fluctuations in budgeted financial requirements from year to year.

Many municipalities provide for a portion of their total annual operating budget to be set aside each year exclusively for capital expenditures. These allocations are normally referred to as "transfers to capital" or "current contributions to capital." These allocations are either provided as a percentage of the total operating budget, an annual dollar allotment or managed over a longer term by planning future tax rates. These allotments, which are set aside annually, may not be immediately required from one year to the next. In these situations, the amounts not required are transferred to a reserve for future capital use. The main focus of this pre-planning is to smooth the impact on the operating budget over a period of years, so that erratic tax rate movements are not experienced. More details on this long term planning are provided in Chapter 6.

TABLE 3-1
CAPITAL FINANCING SOURCES

Financing Sources	Operating Budget/Reserve Impact	Who is Affected
Operating Budget Transfers	"In year" provisions within operating budget	Current year taxpayer, users
Reserves - General	Past contributions from operating budgets, operating surplus, sale of assets	Past taxpayer, users
Reserves - Asset Replacement	Generally, past policies to set aside money for future equipment/asset replacement	Past taxpayer/user rates
Reserves - Development Charges	Money collected under *Development Charges Act* as growth occurs	Developers/builders/landowners
Reserves - Parkland	Collected under Parkland Dedication provisions of *Planning Act*	Developers
Grants/Subsidies	nil	Provincial/Federal
Fundraising	nil	Community groups, residents
Public/Private Partnerships or Public/Public Partnerships	Depending on agreement, may have future operating budget impacts	External service providers, perhaps future taxpayers
Debenture Debt or other long-term agreements	Future operating budget impacts for repayment of debt	Future taxpayers, users
Provincial Acts (e.g. *Local Improvement Act, Drainage Act, Municipal Act*)	May have a component of the costs which are non-recoverable from landowners, would impact on "in year" operating budget or future debt	Benefiting landowners

From time to time, municipalities may own assets (e.g. surplus real estate or buildings) which they no longer require. The sale of these assets can generate a funding source for new capital projects. Sale and lease-back arrangements may be used to monetize existing assets, with significant revenue streams, to generate funding for capital needs.

Reserves and reserve funds are accumulated net reserves which are set aside for future municipal expenditures. Reserves are an appropriation from net revenue set aside by council at their own discretion to be available to meet a future need. The future need does not have to be specific, and the reserve does not have to be segregated from other municipal assets. Reserve funds may be either obligatory or discretionary. An obligatory reserve fund is created whenever a statute requires that monies received be segregated from the general revenues of the municipality. Examples are revenues received under certain provisions of the Development Charges Act, Planning Act, or Municipal Act. Council may establish discretionary reserve funds to earmark revenue for particular purposes under the authority of Section 163 of the Municipal Act for any future expenditure for which it may spend money. A detailed review of reserves and reserve funds has been provided by the Ministry of Municipal Affairs and Housing and is included in Appendix D.

A summary of different capital reserves often used by municipalities is provided below:

Capital Reserves

Lifecycle/Asset Replacement Reserves - This type of reserve provides for the future replacement of capital assets such as buildings, facilities, vehicles and equipment. Normally, sums of money are provided in the operating budget and are transferred annually to this reserve to provide for the future replacement of the assets. Although municipalities have not historically been required to depreciate assets in their accounting practices, future changes in provincial reporting may eventually require this. Hence, municipalities will evolve their financial planning and reporting over time to reflect a more accurate picture of the depreciation or "using up" of their physical assets.

Future Acquisitions - Some municipalities establish special reserves for the future acquisition of large projects. Annually, monies may be set aside in the operating budget to contribute to this fund or contributions may also be made from the sale of other assets or annual operating surplus transferred to these accounts.

Unallocated Capital - Also referred to as a contingency reserve, this account provides for money to be set aside for either emergency purposes or to fund unexpected overruns in capital project expenditures.

3.3 EXTERNAL FINANCING

Historically, municipal authority to raise revenues to finance capital services has been relatively restrictive. Municipalities have had some legislative powers to impose special rates and fees, and traditionally have had provincially and federally funded grant programs available to them. In very recent years, with financial and service reforms at the provincial level, grant and subsidy programs have been significantly reduced. Some programs for capital are still available but these are primarily directed to health and safety issues. From time to time, additional programs may become available; however, the overall direction of senior levels of government at this time is to encourage municipalities to become increasingly self-reliant on their own financial resources.

Municipalities have had some success in initiating fundraising programs for recreation or cultural projects which are of community interest. Common examples include construction of new arenas, community centres, pools, parks, libraries, etc. However, some municipalities have experienced difficulties in reaching their fundraising targets apparently due to a market saturation in fundraising events. Many clubs and social program providers have turned to annual funding drives to cover basic operating expenses in the face of declining availability of government sourced grant funding for this purpose. As well, in recent times, hospitals, schools and college/universities have initiated their own campaigns, thus limiting potential money available from the general public. This funding source should not be ignored; however, realistic objectives should be established before initiating a project.

Over the past few years, a number of legislative reforms have been introduced which have expanded municipal powers. For example, Bill 40 introduced in 1993 provides for public/private sector funding involvement. Others have restricted municipal powers: for example Bill 98 made amendments to the *Development Charges Act* that eliminated the eligibility of certain services.

The methods of external capital cost recovery currently available to municipalities are provided as follows:

TRADITIONAL RECOVERY METHODS		**SECTION REFERENCE**
• *Development Charges Act, 1997 (Bill 98)*		3.3.1
• *Municipal Act*		3.3.2
• Heavy Loading Charges	s.218	
• Sewer and Water Area Charges	s.221	
• Connection Fees	s.222	
• Other Acts		
• eg. *Local Improvement Act, Drainage Act* and other special Acts		3.3.3
• Recent Legislative Reforms		
• *Municipal Act*, s.210		3.3.4
• Bill 26 (*Savings and Restructuring Act*)		3.3.5
• Capital Reserve Funds		
• Other Statutory Reserve Funds		3.3.6.1
• Trust Funds/Donations/Special Purpose Funds		3.3.6.2

3.3.1 *Development Charges Act, 1997 (Bill 98)*

In November, 1996, the Ontario Government introduced Bill 98, a new *Development Charges Act*. The Province's stated intentions were to "create new construction jobs" and "make home ownership more affordable" by reducing the charges, and to "make municipal council decisions more accountable and more cost effective" through the requirement for municipal contributions to all projects. The *Act* allows municipalities to recover capital costs related to growth. The general elements of the new Act are provided below:

- The cost must be "capital".

- It must involve a direct expenditure or expenditure under an agreement, by a municipality or local Board, within or outside the municipality.

- It must be reasonably attributable to the need resulting from development in the municipality.

- It must be net of capital grants, subsidies and other contributions made or anticipated.

- Certain services may not be financed from development charges. Specifically excluded from eligibility are parkland acquisition, administration headquarters, cultural or entertainment facilities, tourism facilities, and hospitals.

- The level of service used in the calculation of capital costs must not exceed the **average level of service** over the previous decade.

- Uncommitted excess capacity available in **existing municipal facilities** and benefits to existing residents should be removed from the calculation of the charge.

- The development charge revenues collected by municipalities **must only be spent on those capital costs** identified in the calculation of the development charge.

- **Municipalities are required to reduce certain DCA eligible capital costs and contribute funds** (e.g. taxes, user charges or other non-development charge revenues) to the financing of certain projects primarily funded from development charges. A municipal contribution of 10 percent is required for services such as recreation, parkland development, libraries, and transit.

- Municipalities are permitted to grant developers **credits for the direct provision of services** identified in the development charge calculation and, when credits are granted, require the municipality to reimburse the developer for the costs the municipality would have incurred if the project had been financed from the development charge reserve fund.

- Provisions for **front-end financing** capital projects required to service new development are set out.

- Provisions for **appeals and complaints,** and **transitional rules** are also set out.

3.3.2 Municipal Act

- Section 218 (Heavy Loading Charges) permits a municipality, with the approval of the OMB, to pass by-laws identifying classes of buildings which may, in the opinion of Council, impose a heavy load on sanitary or storm sewers or water supply. A charge is applicable if such heavy load, in the opinion of council, requires expenditures to provide additional capacity to these municipal services that would not otherwise be required. Such charges are payable on building permit application, or at any time thereafter. However, there are significant exemptions from such charges (all single, semi and duplex units and lands subject to a subdivision agreement).

- Section 221 (Sewer and Water Charges) permits a local municipality to impose a charge by by-law on owners or occupants of land who will or may derive a benefit from the construction of sewage or water works being authorized (in a Specific Benefit Area). OMB approval is no longer required for such a by-law. Thus, charges on individual parcels can be deferred, exemptions can be established (eg. existing residential), repayment can be secured, a mechanism can be defined to establish the rate and non-abutting owners can be charged. Rates may be imposed in respect of costs for major capital works, even though an immediate benefit is not enjoyed. Finally, recovery is authorized against existing works, where a new water or sewer main is added to such works, "notwithstanding that the capital costs of existing works has in whole or in part been paid."

- Section 222 (Connection Fees) permits a local municipality, by by-law, to require an owner to pay the cost of constructing service drains from the main sewer line to the property line for buildings being connected to the municipality's sewer and water systems.

  The reference in this section is to "work or service done or furnished". This would appear to include the cost of works or services that are already completed.

3.3.3 *Local Improvement Act*

- A variety of different types of works may be undertaken, such as water mains, storm and sanitary sewers, supply of electrical light or power, bridge construction, sidewalks, road widening and paving. Normally these projects are very localized in nature and a direct benefit to properties can be identified.

- Council may pass a by-law for undertaking such work as a result of the petition of a majority of benefiting taxpayers. A two-thirds vote of council is required to approve the by-law, or it may be imposed to address health concerns on the recommendation of the Minister of Health. The by-law must go to the Ontario Municipal Board, which may hold hearings, and has the power to alter the by-law in response to any objections.

- The entire cost of a work is assessed only upon the lots abutting directly on the work, according to the extent of their respective frontages and using an equal special rate per metre of frontage.

3.3.4 *Municipal Act, Section 210 - Innovative Financing*

Bill 40 (1993) introduced three major initiatives to stimulate community economic development and to provide new, innovative methods of financing local government capital works. The Bill:

- amended the *Municipal Act* to give municipalities new powers to enter into agreements with the private sector for the provision of and/or financing of capital facilities;

- gave authority to municipalities, school boards, colleges, universities and hospitals to pool funds to invest jointly;

- attempted to assist local businesses by providing for the registration of community economic development corporations that may provide capital and business advice to new or expanding eligible businesses.

With respect to the financial powers to provide municipal infrastructure, the bill amended section 210.1 of the *Municipal Act* to give councils the power to enter into agreements for the provision of municipal capital facilities with the private sector. Financial or other assistance may be provided by the municipality to persons willing to provide municipal capital facilities through exemption from taxation and development charges on land and structures to be provided for municipal use in certain circumstances. The key aspects of section 210.1 are summarized below:

- Section 210.1(2) provides that the council of a municipality may enter into agreements for the provision of municipal capital facilities by any person.

- Section 210.1(3) provides that such agreements may allow for the lease, operation or maintenance of such facilities by any person and will permit that sale or other disposition of municipal land or buildings that are still required for the use by the municipality.

- Section 210.1(4) allows municipalities to extend financial or other assistance at less than fair market value or at no cost to persons with whom the municipality has contracted for the provision of capital facilities. This assistance may include: (1) the lending of money; (2) lending, leasing or selling of property; (3) a guarantee on borrowing; or (4) providing the services of municipal employees. Section 210.1(5) requires that any assistance provided by the municipality must be solely in respect of the provision, lease, operation or maintenance of the facilities that are the subject of the agreement.

- Section 210.1(7) allows municipalities, in certain circumstances, to grant property tax exemptions to private sector entities in respect of municipal capital facilities provided to the municipality by such entities.

- Section 210.1(8) provides that by-laws passed under section 210.1(7) may also provide a full or partial exemption from the facilities from payments required under the *Development Charges Act*.

In most instances, no approval by the Ontario Municipal Board or Ministry of Municipal Affairs and Housing is required relative to the above. The province will, however, retain a degree of supervisory contact through its power under 210.1(19) to make regulations defining "municipal capital facilities" and prescribing the municipal capital facilities or clauses which may or may not be eligible for inclusion of an agreement under 210.1(2).

Ontario Regulation 46/94 (February 11, 1994) provided the regulations for the new Act. With respect to agreements established under s.210.1(2) of the *Municipal Act*, a municipality may provide for the following classes of municipal capital facilities:

- facilities used by the council;
- facilities used for the general administration of the municipality;
- municipal roads, highways and bridges;
- municipal local improvements and public utilities, except facilities for the generation of electricity;
- municipal facilities related to the provision of telecommunications, transit and transportation systems;
- municipal facilities for water, sewers, sewage, drainage and flood control;
- municipal facilities for the collection and management of waste and garbage;
- municipal facilities relating to policing, firefighting and by-law enforcement;
- municipal facilities for the protection, regulation and control of animals;
- municipal facilities related to the provision of social and health services, including homes under the *Homes for the Aged and Rest Homes Act;*
- municipal facilities for public libraries;
- municipal facilities that combine the facilities described in the above;
- municipal community centres;
- parking facilities ancillary to facilities described in any of the above; and
- municipal facilities used for cultural, recreational or tourist purposes including municipal general parking facilities and ancillary parking facilities.

As provided by the amendments to the *Municipal Act*, the opportunities for municipalities to enter into new financial arrangements have been considerably expanded. These arrangements now provide alternatives to traditional debenturing, ranging from simple leasing agreements to private sector owned and operated facilities.

3.3.5 Bill 26, *Savings and Restructuring Act, 1996*

Bill 26 was introduced to the legislature and given first reading November 29, 1995. Royal Assent was given January 30, 1996. The primary purpose of the *Act*, known as the *Savings and Restructuring Act*, was "to achieve fiscal savings and promote economic prosperity through public sector restructuring, streamlining and efficiency and to implement other aspects of the government's agenda." Part 10 of Schedule M provided changes to the *Municipal Act* and granted municipalities and local boards broader powers to impose fees or charges for any services or activities provided by them. A summary of the *Act's* provisions is set out below:

3.3.5.1 Municipalities may impose, by by-law, fees or charges on any class of person:

- for services provided by the municipality
- for costs of services provided by the municipality
- for the use of property owned or under control of the municipality

3.3.5.2 No by-law shall impose a fee or charge that is based on or in reference to:

- the income of a person (an exception is made relative to exempting any class of person from the fee or charge)
- the use, purchase or consumption of property except property owned or controlled by the municipality or local board passing the by-law
- the use, purchase or consumption or a service or the benefit received by a person except a service provided by the municipality or local board passing the by-law
- the generation, exploitation, extraction, harvesting, processing, renewal or transportation of natural resources.

3.3.5.3 Municipalities may not impose a poll tax or similar fee or charge. As well, municipalities may not use this Act to recover growth-related net capital costs.

3.3.5.4 Fees and charges passed under this Act constitute a debt of the person to the municipality or local board. Unpaid fees and charges may be added to the tax roll for any real property and collected in a like manner to taxes.

3.3.5.5 The Minister of Municipal Affairs and Housing may, by regulation, prohibit municipalities from charging certain fees.

3.3.6 Capital Reserve Funds

3.3.6.1 Statutory Reserve Funds - These reserve funds are established in accordance with a provincial statute where funds collected for a specific purpose must be set aside, accounted for separately and used only for an intended purpose. Examples include development charges, parkland dedication, cash-in-lieu, etc.

3.3.6.2 Trust Funds/Donations/Special Purpose Funds - At times, revenue may be collected or received and directed to a specific use. If a specific purpose has been defined as a condition of its receipt, the revenue must be set aside in special purpose reserve or trust funds to be used only for these purposes.

4. CAPITAL BUDGET DOCUMENTATION

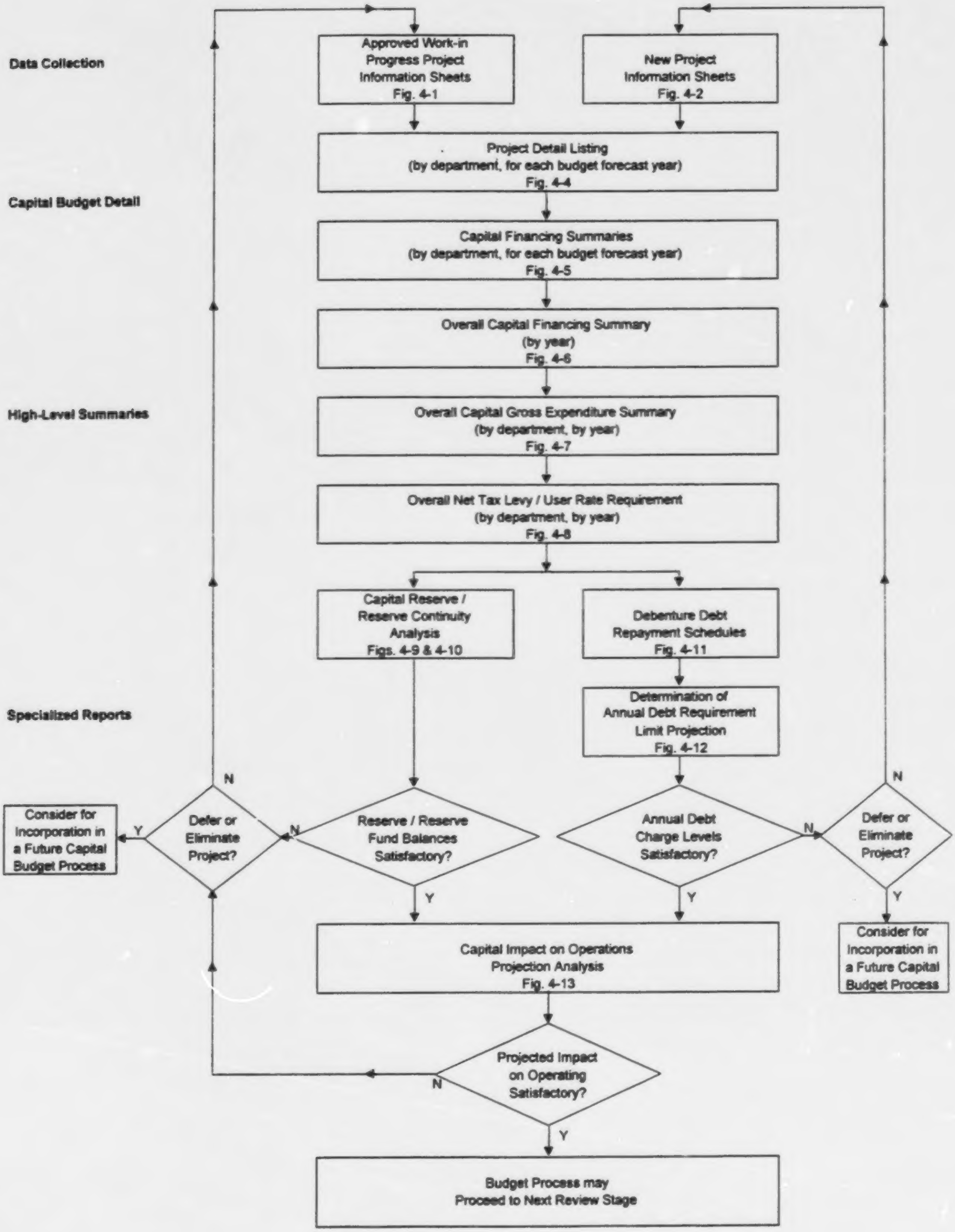
4. CAPITAL BUDGET DOCUMENTATION

4.1 OVERVIEW OF DOCUMENTS

The Municipal Capital Budgeting software developed by the Ministry of Municipal Affairs and Housing is designed in a generic format to facilitate the flow of information and the preparation of budget summaries and analytical schedules for financial management purposes during the budget process. Chapter 4 provides (i) an overview of the budget documents, reporting formats and analysis schedules featured on the software and (ii) an explanation of their use during the budget cycle:

	see Figure #
Capital Budget Detail (for each year of the budget forecast)	
• capital project information sheets (for both new project requirements and ongoing work-in-progress)	4-1 and 4-2
• capital project detail listing	4-4
• annual financing summary (by department)	4-5
High Level Summaries (for all years of the budget forecast)	
• financing summary	4-6
• gross expenditure summary	4-7
• net tax levy/user rate summary	4-8
Specialized Reports	
• reserves and reserve funds continuity schedules	4-9 and 4-10
• debenture debt repayment schedules	4-11
• determination of annual repayment limit projection	4-12
• capital impact on operations projection analysis	4-13

SCHEDULE 4-1
CAPITAL BUDGET DOCUMENTATION OVERVIEW


Data Collection
Approved Work-in Progress Project Information Sheets Fig. 4-1
New Project Information Sheets Fig. 4-2
Capital Budget Detail
Project Detail Listing (by department, for each budget forecast year) Fig. 4-4
Capital Financing Summaries (by department, for each budget forecast year) Fig. 4-5
Overall Capital Financing Summary (by year) Fig. 4-6
High-Level Summaries
Overall Capital Gross Expenditure Summary (by department, by year) Fig. 4-7
Overall Net Tax Levy / User Rate Requirement (by department, by year) Fig. 4-8
Capital Reserve / Reserve Continuity Analysis Figs. 4-9 & 4-10
Debenture Debt Repayment Schedules Fig. 4-11
Specialized Reports
Determination of Annual Debt Requirement Limit Projection Fig. 4-12
Consider for Incorporation in a Future Capital Budget Process
Y
N
Defer or Eliminate Project?
N
Reserve / Reserve Fund Balances Satisfactory?
Y
Annual Debt Charge Levels Satisfactory?
N
Y
N
Defer or Eliminate Project?
Y
Consider for Incorporation in a Future Capital Budget Process
Capital Impact on Operations Projection Analysis Fig. 4-13
Projected Impact on Operating Satisfactory?
N
Y
Budget Process may Proceed to Next Review Stage

4.2 CAPITAL BUDGET DETAIL

Capital Project Information Sheets

As discussed in Chapter 2, one of the initial phases of the budget cycle involves the collection of information on the future capital requirements of the municipality. This stage would (i) identify all projected new capital projects and the related expenditure requirements and (ii) review and evaluate current ongoing projects to confirm or amend their future expenditure requirements (discussed further in the next section). Two capital project information sheets have been developed for this purpose and are illustrated in Figures 4-1 and 4-2 for new and ongoing (work-in-progress) capital projects.

The project information sheet is the source of data entry for the capital budgeting software. Any amendments made to the projects may be updated on the project information sheet at any time throughout the budget process. For example, project cost estimates, timing of expenditures, sources of financing, priority assignments, etc. may all be updated as better information becomes available or as refinements are identified to fit the forecast within financial constraints. All summaries will be updated to reflect the changes made at this source.

Each of the individual information requirements necessary to complete the project information sheets is discussed briefly below:

Project Identification

In the upper right hand corner of the form an area is provided for the municipality to assign a "project number" or other method of differentiating a specific project from all others being considered, to avoid confusion and to facilitate processing of information.

Then the proposed year of initiation of the project is entered. This is to assist in arranging various project requests in a table according to their respective starting time. Whether or not there is flexibility in the timing of the project is important information. Adjustments in the timing of projects will be required at various stages throughout the process right up until

FIGURE 4-1

DATA COLLECTION PROCESS

PROPOSED PROJECT INFORMATION SHEET

Project ID
Year of Initiation
Flexible? Y/N

DEPARTMENT ____________________

SERVICE / PROGRAM ____________________

PROJECT NAME ____________________

PROJECT DESCRIPTION / NEED FOR WORK

____

____

____

____

PROJECT PRIORITY		Indicate H(igh)/M(edium)/L(ow):	COMMENT:
Health or Safety Issue?	☐		
Cost Savings/Payback?	☐		
Asset Maintenance/Replacement?	☐		
Growth Related Need?	☐		
Service Enhancement?	☐		
Other? (i.e. community projects)	☐		

PROJECT BUDGET	**TOTAL EXPENDITURE/ FINANCING**	**CASHFLOW PROJECTION**					
		YEAR 1	**YEAR 2**	**YEAR 3**	**YEAR 4**	**YEAR 5**	**POST PERIOD**
Expenditures:		(Indicate either $ or % allocation across budget years where applicable)					
STUDIES							
LAND							
ASSET PURCHASE							
UTILITIES/DESIGN							
CONSTRUCTION							
FURNISHINGS/EQUIPMENT							
SITEWORK/LANDSCAPING							
CONTINGENCY							
INTERIM FINANCING COST							
OTHER							
TOTAL EXPENDITURES							
Financing:							
External Sources							
GRANTS/SUBSIDY							
DIRECT DEVELOPER CONTRIBUTION							
EXTERNAL CONTRIBUTION (Partnership, etc.)							
OTHER (Fundraising, etc.)							
Revenue Fund							
FROM OPERATIONS (Tax Base)							
FROM OPERATIONS (User Rates)							
Reserves/Reserve Funds							
FROM CAPITAL RESERVE							
FROM OTHER RESERVE							
FROM DC RESERVE FUND							
FROM OTHER RESERVE FUND							
Long Term Financing							
DEBENTURE							
LEASE							
TOTAL FINANCING							

OPERATING BUDGET IMPACT	**YEAR 1**	**YEAR 2**	**YEAR 3**	**YEAR 4**	**YEAR 5**	**POST PERIOD**
Specify NET Operating Expenditure/Savings						
Specify Expected Useful Life of Asset						

FIGURE 4-2

DATA COLLECTION PROCESS

APPROVED WORK-IN-PROGRESS INFORMATION SHEET

Project ID

Year of Initiation

DEPARTMENT

SERVICE / PROGRAM ______________________________

PROJECT NAME ______________________________

PROJECT DESCRIPTION / NEED FOR WORK

____

____

____

____

PROJECT PRIORITY

		Indicate H(igh)/M(edium)/L(ow):	COMMENT:
Health or Safety Issue?	☐	______________	______________
Cost Savings/Payback?	☐	______________	______________
Asset Maintenance/Replacement?	☐	______________	______________
Growth Related Need?	☐	______________	______________
Service Enhancement?	☐	______________	______________
Other? (i.e. community projects)	☐	______________	______________

PROJECT BUDGET

Expenditures:	PRIOR APPROVED BUDGET	EXPENDED/ FINANCED TO-DATE	PROJECTED EXPENDITURE/ FINANCING	REVISED CASHFLOW PROJECTION YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	POST PERIOD
				(Indicate either $ or % allocation across budget years where applicable)					
STUDIES									
LAND									
ASSET PURCHASE									
UTILITIES/DESIGN									
CONSTRUCTION									
FURNISHINGS/EQUIPMENT									
SITEWORK/LANDSCAPING									
CONTINGENCY									
INTERIM FINANCING COST									
OTHER									
TOTAL EXPENDITURES									
TOTAL PROJECT				- check to Approved Budget-to-date					

Financing:

External Sources									
GRANTS/SUBSIDY									
DIRECT DEVELOPER CONTRIBUTION									
EXTERNAL CONTRIBUTION (Partnership, etc.)									
OTHER (Fundraising, etc.)									
Revenue Fund									
FROM OPERATIONS (Tax Base)									
FROM OPERATIONS (User Rates)									
Reserves/Reserve Funds									
FROM CAPITAL RESERVE									
FROM OTHER RESERVE									
FROM DC RESERVE FUND									
FROM OTHER RESERVE FUND									
Long Term Financing									
DEBENTURE									
LEASE									
TOTAL FINANCING									
TOTAL PROJECT									

OPERATING BUDGET IMPACT

	TO-DATE		YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	POST PERIOD
Specify NET Operating Expenditure/Savings								
Specify Expected Useful Life of Asset								

approval by council as resources are allocated among the various projects and the most important priorities are identified and justified. If no flexibility in the timing of the project is noted, then an appropriate explanation should be provided in the project justification and priority sections of the form.

Department and Service/Program

The department and the service/program identifies the section of the organization that will be responsible for managing the implementation of the project and under whose authority the request is being brought forward. They will be responsible for providing any justification of the project or additional information that may be requested by council or the public throughout the balance of the process. This identification also assists in the organization of information as all projects from each area of responsibility will be presented together.

Project Name, Description and Need

The project should be assigned a recognizable (short) name that may be used in project listings or other reports. Additional space has been provided to provide a more complete verbal description of the project for clarification, and to provide a brief justification of the need for the project.

Project Priority

The project information sheet includes a list of "criteria categories" that are frequently used by municipalities in ranking the priority of various capital projects. Consideration of these criteria will be used to determine which projects should proceed more expeditiously than others. Is the project related to a health or safety issue? Is there a cost savings or payback period associated with this project? Is the project a replacement of or capital maintenance on an existing municipal asset? Is the project related to a growth related need? Is the project related to a desired service enhancement? Will the project serve to meet another municipal objective? (i.e. is it a community based project?) Figure 4-3 provides a schematic overview of these priorities and examples of the types of items which would be included in each category. The developed software will permit the municipality to assign its own relative importance to each of the specified criteria in order to provide the flexibility to meet the needs of individual municipalities.

Within each "criteria category" it is possible to assign a further H(igh), M(edium), or L(ow) ranking. This assignment allows municipalities to differentiate further between particular projects in relative priority rankings. For example, in ranking projects it is important to be able to distinguish between a capital asset replacement project, which is required on an emergency basis (may be assigned a 'H' priority), from a project which is five to ten years beyond its regularly scheduled replacement (may be assigned a "M" priority), and from a project that is scheduled now for replacement (may be assigned a "L" priority). A comment may also be provided to substantiate or explain the rationale as to why a particular priority has been assigned to the project.

The project priority information provided above is used by the capital budgeting software to produce a detailed project listing. It shows either gross project cost or net tax levy/user rate requirement in columns across for each year of the capital forecast. Depending upon the financial resources available to the municipality, a financing constraint point can then be determined beyond which projects remain unfinanced unless additional resources can be identified and allocated to fund the capital program.

Resources will not likely be available to finance all high, medium, and low priorities. Nonetheless, identification of the capital needs of the municipality is an important management function. Low priorities should be identified and documented to assist in future capital planning and scheduling of projects. The information assembled will then be useful in identifying the need for financial resources five to ten years in the future. In turn, this may influence the establishment of longer term financial policy objectives by council and the community.

Project Expenditures

The next section of the form is designed to capture information relating to the type, amount, and timing of all expenditures related to the project. The total project budget should be broken down by expenditure component. The timing of expenditures is then scheduled in accordance with the best available estimates. The expenditures are expected to be incurred during each year of the forecast period. The information is entered on the project expenditure cash flow projection table.

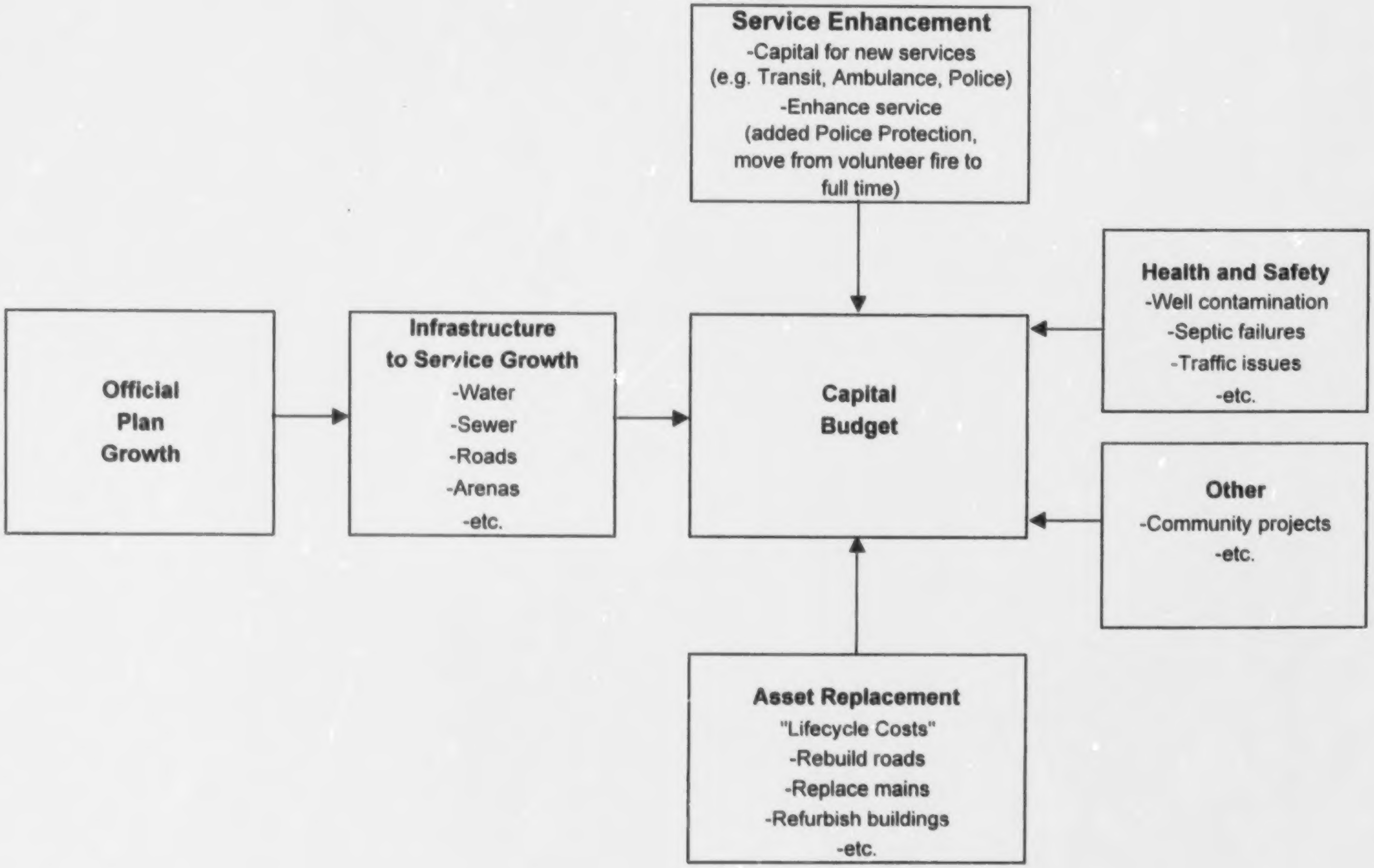
Municipalities have traditionally allocated complete financing to a capital project in the year of its approval. This implied that financing was in place prior to a project proceeding to tender. However, it often resulted in an inefficient use of capital, particularly for larger projects spanning two, three, or more calendar years, as financial resources may be sitting in the accounts pending initiation or the construction of the project.

Projecting expenditures on a cash flow basis offers the distinct benefit of allocating resources to the project on an "as needed" (in each fiscal year) basis. This method of capital budgeting offers municipalities the potential to finance a greater number of projects concurrently, and to minimize the amount of "idle" capital, which results in a more efficient overall use of resources. A municipality could mitigate the effects of "idle" capital by using smart cash management policies and practices. It must be emphasized , however, that once a contract has been tendered the municipality is legally committed to meet their obligations under the contract and, hence, will be obligated to raise the funds as required. The project, once approved, represents a future commitment on the part of council (over and above the financing actually provided to the project under the cash flow budget). As a result, greater sophistication in the capital budgeting and efficiency improvements associated with cash flow budgeting.

The capital budgeting software has been designed to assist municipalities in the implementation of capital budgeting on a cash flow basis.

FIGURE 4-3

NEEDS FOR CAPITAL WORKS - PRIORITY ISSUES


Service Enhancement
-Capital for new services
(e.g. Transit, Ambulance, Police)
-Enhance service
(added Police Protection,
move from volunteer fire to
full time)
Official
Plan
Growth
Infrastructure
to Service Growth
-Water
-Sewer
-Roads
-Arenas
-etc.
Capital
Budget
Health and Safety
-Well contamination
-Septic failures
-Traffic issues
-etc.
Other
-Community projects
-etc.
Asset Replacement
"Lifecycle Costs"
-Rebuild roads
-Replace mains
-Refurbish buildings
-etc.

Project Financing

Sources of financing of project expenditures are to be identified in the project financing cash flow projection table. External sources of financing, if available, will typically be identified by the department responsible for management of the project. The Finance or Treasury department will usually have responsibility for assigning internal sources of financing (reserves, tax levy, etc.) and for recommending which municipal projects should be debenture financed, although responsibility for this function may vary among municipalities.

Sources of financing, if not identified, will default either to tax levy or user rates, or to debenture debt (to be specified by the municipality). The default source of financing, therefore, will not be entered as it is calculated by the software. Financing for each year of the cash flow projection must be equal to the expenditures projected for that year.

Operating Budget Impact

The operating budget impact of the capital project (net of associated revenue) is to be projected for each year of the forecast period. The amounts projected here are incorporated into the Capital Impact on Operations Analysis Schedule (see Figure 4-13).

The useful life of the capital asset may be estimated and documented on this form. This information may enable the municipality to determine what could be the annual amount required to replace the asset or acquire a similar asset in the future and to hold accountable those responsible for the use of the asset over its useful life.

Capital Project Information Sheets (Approved Work-in-Progress)

The capital project information sheet for existing work-in-progress is very similar to the information sheet for proposed new projects with a few minor exceptions. A project information sheet for the current budget preparation cycle should be prepared if:

- It was indicated in the preparation of the previous capital budget that expenditures would be incurred and financing would be raised (using the cash flow model) during a year covered by the capital budget and forecast period of this budget cycle.

- Additional financing is required to fund an unanticipated over-expenditure for an existing project.

During the current budget cycle, existing approved work-in-progress projects should be reviewed and brought forward if financing is required to be raised during this budget forecast period. It is important to distinguish between previously committed projects from new project requests since previously committed financing will reduce the resources available to be allocated during this cycle. Existing work-in-progress should also be reviewed to determine if any revision or update to the financing is necessary. Where this is the case, the requested revision in cost or timing should be clearly denoted as the revision being requested has not actually received the approval of council yet.

The expenditures to date and financing applied to the project to date are new elements to be included on this information sheet that do not apply to new project requests.

Capital Project Detail Listing

A detailed listing of all capital projects is produced separately for each year of the capital budget and forecast period as a report from the system (see Figure 4-4). The report organizes projects by Department and Service/Program and indicates proposed sources of financing in columns across the page. Sources of financing are organized first by external sources of financing, such as grants or contributions by developers, and then by internal sources of financing such as tax levy or user rates, reserves and reserve funds and debenture debt. The report indicates for each project whether it is an approved current work-in-progress project or whether it is a new project request. Separate sub-totals are provided for both approved projects and new project requests at the Service/Program level of the department. A total is then provided for the department as a whole, with a grand total for the capital budget year.

This report permits the user to see at a glance the capital program being put forward by each service responsibility area for any particular year during the forecast period, and to see the extent to which the resources for that period have already been committed by prior budget approvals.

A number of alternative capital project detail listings may be produced from the system:

- A report similar in format to that described above can be produced and organized by project priority grouping.

- A detailed listing of all capital projects integrated for all budget and forecast years can be produced. The report can be organized either departmentally or by project priority grouping, and can be used to list either gross budgeted expenditures or tax levy/user rate requirements for each budget forecast year, in columns across the page.

Annual Financing Summary

A separate one page budget summary is available (see Figure 4-5) for each year of the budget and forecast period which summarizes the total value of approved and new project requests submitted by Department and Service/Program. The recommended sources of financing are listed in columns across the page. This summary enables the user to review budget requests submitted for each year of the capital budget forecast.

Reserve and reserve fund contributions made to capital each year are carried forward from this summary to the Reserve and Reserve Fund Continuity Schedules (see Figure 4-9 and Figure 4-10).

4.3 HIGH LEVEL BUDGET SUMMARIES

Since these summaries are produced at a high level for the entire capital budget and forecast projection period, they are all rounded to thousands of dollars which should be suitable for most small to medium sized Ontario municipalities.

Financing Summary

A one line summary of the gross capital budget and sources of financing is listed for each year of the budget and forecast period, and is then totalled for the entire budget projection period (see Figure 4-6). If specific financial constraints have been provided by the municipality (i.e. tax levy/user rate revenue constrained to a particular level, debt charges constrained to a particular level), then this summary can also provide the municipality with an indication as to the amount of the capital program remaining unfinanced under these constraints by referring to the column headed "Unfinanced".

The total amount to be debentured in each year is then carried forward from this summary to the Debenture Debt Repayment Projection schedules (see Figure 4-11). The annual contributions to capital from the tax levy and user rates are carried forward from this summary to the Capital Impact on Operations Analysis schedule (see Figure 4-13).

Gross Expenditure Summary

This report produces a one line summary indicating the gross expenditure for each year of the capital budget projection period by Department and Service/Program with a grand total for all budget years and for all departments (see Figure 4-7). This summary provides the user with an overall summary of the magnitude of the capital program being put forward for approval, as well as with an indication as to the overall allocation of resources by department over the projection period. The total expenditures for each year should balance to the total financing for each year on the Financing Summary report (see Figure 4-6).

Net Tax Levy/User Rate Summary

This report is produced in the same format as the Gross Expenditure Summary, but reports the net tax levy or user rate financing requirement by Department and Service/Program for each year of the capital budget projection period (see Figure 4-8). The total tax levy and user rate requirements should balance with these respective columns on the Financing Summary for each year of the projection period (see Figure 4-6).

4.4 SPECIALIZED REPORTS

A number of specialized reports are available through the capital budgeting software that are designed to assist the Finance or Treasury department with their reserve and debt analysis and management responsibilities. Each of these reports is discussed briefly below:

Reserve and Reserve Funds Continuity Schedules

The municipality must provide information with respect to the opening balances in each of their capital reserves and reserve funds at the beginning of the capital budget forecast period. The amount of revenue, to be contributed either by the municipality or from another source into each reserve for each year of the forecast period, must also be provided as input to the system. Contributions to reserves and reserve funds from operations (tax levy or user rates) are carried forward to the Capital Impact on Operations Analysis schedule (see Figure 4-13).

The amounts to be contributed to the capital program each year from reserves and reserve funds will automatically be updated by the system as financing is assigned from the reserve or reserve fund to finance each project on the project information sheets.

Interest earned on each reserve fund will be calculated by the software based on the interest rate assumptions used by the municipality. The software assumes that all contributions to/from a reserve fund during a year will earn interest for half of a year.

Using the above information, the software projects the reserve and reserve funds balances available during the capital budget forecast period (see Figure 4-9). The Finance or Treasury department can use this information in assessing the availability of reserve monies to be used in financing the ongoing capital program. Application of reserve funds, where it is deemed appropriate, can be made by updating the individual capital project information sheets.

Based on the present rules and practice, a separate reserve fund continuity schedule may be used to provide a separate accounting of projected balances in the municipality's Development Charge Reserve Fund by service component (see Figure 4-10). The totals in the Development Charge Reserve Fund schedule then update the DC Reserve Fund column on the main continuity schedule. (This would change if DCA receipts are to be deemed deferred revenues.)

Debenture Debt Repayment Schedules

Using the total projected debenture requirement obtained from the Financing Summary Schedule (Figure 4-6), the Debenture Debt Repayment Schedule projects operating debt charges. The municipality is required to provide assumptions regarding anticipated debt interest rates, the term of the debt to be issued, and the portion of debt charges to be charged to the operating budget in the first year. The municipality is also required to provide the existing debt charges applicable for each of the future years of the forecast period.

Using this information, the capital budgeting software calculates the projected impact of anticipated new total debt charges (see Figure 4-11), and carries this information forward to the Determination of Annual Debt Repayment Limit Schedule (see Figure 4-12), and to the Capital Impact on Operations Analysis Schedule (see Figure 4-13).

Determination of Annual Debt Repayment Limit Projection

Each year the Ministry of Municipal Affairs and Housing provides each municipality with a calculation of its Annual Debt Repayment Limit based on information provided in the most recently available Financial Information Return (FIR) for the municipality (see Chapter 5 for a more detailed description).

A schedule has been provided in the capital budgeting software to enable municipalities to project and monitor anticipated changes in their debt capacity which arises from the degree of reliance on debt in the capital program that they approve in principle (see Figure 4-12). The schedule has been prepared in a very similar format to that provided annually by the Ministry, with the exception that it has the ability to project forward for the capital budget forecast period.

The municipality is required to estimate the anticipated increases in total own purpose revenue fund revenues. The projected new debt charges arising from the capital program are brought forward from the Debenture Debt Repayment Schedule (see Figure 4-11) to be incorporated into this analysis. The new remaining debt capacity information is then calculated. This information assists the municipality in quickly assessing whether the amount of debt in their proposed capital program will result in an increase, a decrease, or no significant change from their existing debt capacity level.

Capital Impact on Operations Projection Analysis

The municipality is required to provide some basic information from the previous year's approved budget regarding the current level of contributions to capital and reserves, budget, and the current level of the net budget being raised from the tax levy or user rates. The Capital Impact on Operations Projection Analysis Schedule (see Figure 4-13) analyses changes in the municipal tax rate year-over-year as well as on a cumulative basis over the capital budget projection period using information gathered from the capital budget summaries and schedules such as the following:

- projected contributions to capital,
- projected contributions to reserves and reserve funds,
- projected new debt levels,
- projected new operating expenditures arising from capital projects.

The information in Figure 4-13 provides the municipality with an assessment of both the degree of variability in the impact of capital on operations over the forecast period, and the total anticipated impact on the tax or user rates over a number of years. Action can then be taken to either reduce (or increase) the capital program in total over the period, or to adjust project timing in order to smooth impacts between years. To assist with this type of decision the software will calculate and display the amount in tax dollars or in debt to be issued that would have to be deferred or refinanced in the capital budget in order to produce a 1% reduction in the bottom line operating net impact. This schedule is very useful in assessing whether or not the proposed capital program meets the financial objectives and policies of the municipality over the long term, and in assisting the user to determine changes that need to be made in order to move more closely to a position where the capital budget and forecast meet those objectives.

FIGURE 4-4
CAPITAL BUDGET DOCUMENT

CAPITAL PROJECT DETAIL LISTING
YEAR 1

			External Sources				Internal (Revenue Fund)		Internal (Reserves/Reserve Funds)						Long Term Financing	
Project Description	APP./NEW*	GROSS COST	GRANTS/SUBSIDIES	DEVELOPER CONTRIB.	EXTERNAL CONTRIB.	OTHER	TAX LEVY	USER RATES	CAPITAL RESERVE	EQUIPMENT RESERVE	SEWER/WATER RESERVE	OTHER RESERVE	DC RESERVE FUND	RESERVE FUND	DEBENTURE DEBT	LEASE
DEPARTMENT A SERVICE/PROGRAM:																
Project 1																
Project 2																
Project 3																
Etc. ...																
Sub-total - Approved																
Sub-total - New																
Sub-total - Service/Program																
SERVICE/PROGRAM:																
Project 1																
Project 2																
Sub-total - Approved																
Sub-total - New																
Sub-total - Service/Program																
SERVICE/PROGRAM:																
Project 1																
Project 2																
Sub-total - Approved																
Sub-total - New																
Sub-total - Service/Program																
DEPARTMENT A TOTAL																
Etc. ...																
YEAR 1 TOTAL																

* APP. = Approved Work-in-progress; NEW = New Proposed Project

FIGURE 4-5
CAPITAL BUDGET DOCUMENT

CAPITAL BUDGET - YEAR 1 SUMMARY

		External Sources				Internal (Revenue Fund)		Internal (Reserves/Reserve Funds)						Long Term Financing	
	GROSS COST	GRANTS/ SUBSIDIES	DEVELOPER CONTRIB.	EXTERNAL CONTRIB.	OTHER	TAX LEVY	USER RATES	CAPITAL RESERVE	EQUIPMENT RESERVE	SEWER/WATER RESERVE	OTHER RESERVE	DC RESERVE FUND	RESERVE FUND	DEBENTURE DEBT	LEASE
DEPARTMENT A /SERVICE - Approved DEPARTMENT A /SERVICE - New DEPARTMENT A /SERVICE															
DEPARTMENT A /SERVICE - Approved DEPARTMENT A /SERVICE - New DEPARTMENT A /SERVICE															
DEPARTMENT B /SERVICE - Approved DEPARTMENT B /SERVICE - New DEPARTMENT B /SERVICE															
DEPARTMENT B /SERVICE - Approved DEPARTMENT B /SERVICE - New DEPARTMENT B /SERVICE															
DEPARTMENT C /SERVICE - Approved DEPARTMENT C /SERVICE - New DEPARTMENT C /SERVICE															
DEPARTMENT D /SERVICE - Approved DEPARTMENT D /SERVICE - New DEPARTMENT D /SERVICE															
YEAR 1 TOTAL															

FIGURE 4-6
CAPITAL BUDGET DOCUMENT

FINANCING SUMMARY

($ 000's)

		External Sources				Internal (Revenue Fund)		Internal (Reserves/Reserve Funds)						Long Term Financing		
	GROSS COST	GRANTS/ SUBSIDIES	DEVELOPER CONTRIB.	EXTERNAL CONTRIB.	OTHER	TAX LEVY	USER RATES	CAPITAL RESERVE	EQUIPMENT RESERVE	SEWER/WATER RESERVE	OTHER RESERVE	DC RESERVE FUND	RESERVE FUND	DEBENTURE DEBT	LEASE	UNFINANCED
YEAR 1																
YEAR 2																
YEAR 3																
YEAR 4																
YEAR 5																
GRAND TOTAL																

FIGURE 4-7
CAPITAL BUDGET DOCUMENT

GROSS EXPENDITURE SUMMARY

($ 000's)

	CURRENT YEAR		YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	TOTAL	
DEPARTMENT A /SERVICE									
DEPARTMENT A /SERVICE									
DEPARTMENT B /SERVICE									
DEPARTMENT B /SERVICE									
DEPARTMENT C									
DEPARTMENT D									
GRAND TOTAL									

FIGURE 4-8

CAPITAL BUDGET DOCUMENT

NET TAX LEVY SUMMARY

($ 000's)

	CURRENT YEAR	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	TOTAL
DEPARTMENT A /SERVICE							
DEPARTMENT A /SERVICE							
DEPARTMENT B /SERVICE							
DEPARTMENT B /SERVICE							
DEPARTMENT C							
DEPARTMENT D							
GRAND TOTAL							

FIGURE 4-9

Interest Rate (%) 4.75%

CAPITAL BUDGET PREPARATION PROCESS

RESERVE CONTINUITY SCHEDULE

	RESERVES		RESERVE FUNDS						
	CAPITAL	EQUIPMENT	DC	SEWAGE	WATER	PARKLAND	...	...	TOTAL
OPENING BALANCES									
YEAR 1									
Contribution from Operations/Dev									
Interest Earned									
Contribution to Capital									
Closing Balances, December 31									
YEAR 2									
Contribution from Operations/Dev									
Interest Earned									
Contribution to Capital									
Closing Balances, December 31									
YEAR 3									
Contribution from Operations/Dev									
Interest Earned									
Contribution to Capital									
Closing Balances, December 31									
YEAR 4									
Contribution from Operations/Dev									
Interest Earned									
Contribution to Capital									
Closing Balances, December 31									
YEAR 5									
Contribution from Operations/Dev									
Interest Earned									
Contribution to Capital									
CLOSING BALANCES									

FIGURE 4-10

Interest Rate (%)	4.75%

CAPITAL BUDGET PREPARATION PROCESS

DEVELOPMENT CHARGE RESERVE CONTINUITY SCHEDULE

	ADMIN.	FIRE	ROADS & RELATED	TRANSIT	PARKLAND DEVELOP.	RECREATION FACILITIES	LIBRARIES	OTHER	TOTAL
OPENING BALANCES									
YEAR 1									
Contribution from Development									
Interest Earned									
Contribution to Capital									
Closing Balances, December 31									
YEAR 2									
Contribution from Development									
Interest Earned									
Contribution to Capital									
Closing Balances, December 31									
YEAR 3									
Contribution from Development									
Interest Earned									
Contribution to Capital									
Closing Balances, December 31									
YEAR 4									
Contribution from Development									
Interest Earned									
Contribution to Capital									
Closing Balances, December 31									
YEAR 5									
Contribution from Development									
Interest Earned									
Contribution to Capital									
CLOSING BALANCES									

FIGURE 4-11
CAPITAL BUDGET PREPARATION PROCESS

Rate (%)	
Term (Yrs)	
Portion charged in first year	

DEBENTURE DEBT REPAYMENT PROJECTION
($ 000's)

TAX SUPPORTED PROGRAM

DEBT ISSUED									
Year	Amount	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	–	–	TOTAL
Existing Debt Charges									
YEAR 1									
YEAR 2									
YEAR 3									
YEAR 4									
YEAR 5									
ANNUAL DEBT REPAYMENT									

RATE SUPPORTED PROGRAM (i.e. Water)

DEBT ISSUED									
Year	Amount	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	–	–	TOTAL
Existing Debt Charges									
YEAR 1									
YEAR 2									
YEAR 3									
YEAR 4									
YEAR 5									
ANNUAL DEBT REPAYMENT									

RATE SUPPORTED PROGRAM (i.e. Sanitary Sewer)

DEBT ISSUED									
Year	Amount	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	–	–	TOTAL
Existing Debt Charges									
YEAR 1									
YEAR 2									
YEAR 3									
YEAR 4									
YEAR 5									
ANNUAL DEBT REPAYMENT									

FIGURE 4-12
(CAPITAL BUDGET PREPARATION PROCESS

DETERMINATION OF ANNUAL DEBT REPAYMENT LIMIT

2% Revenue Fund Revenues Escalation Factor

MUNICIPALITY:

MMAH CODE:

				CURRENT YEAR	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
1.0		GROSS DEBT CHARGES							
	1.1	Principal	PL 12 78 01						
	1.2	Interest	PL 12 78 02						
	1.3	SUBTOTAL	Add lines 1.1, 1.2						
2.0		DEBT CHARGES ON O.C.W.A. PROVINCIAL PROJECT							
	2.1	Water Projects - this municipality only	PL 12 46 03						
	2.2	Water Projects - share of integrated project(s)	PL 12 47 03						
	2.3	Sewer Projects - this municipality only	PL 12 48 03						
	2.4	Sewer Projects - share of integrated project(s)	PL 12 49 03						
	2.5	SUBTOTAL	Add lines 2.1 thru 2.4						
3.0		PAYMENT IN RESPECT OF LONG TERM COMMITMENTS AND LIABILITIES	PL 08 73 08						
4.0		**SUBTOTAL - DEBT CHARGES**	**Add lines 1.3, 2.5, 3.0**						
5.0		DEBT CHARGES FOR MUNICIPAL UTILITIES							
	5.1	Electricity	PL 08 48 02						
	5.2	Gas	PL 08 49 02						
	5.3	Telephone	PL 08 50 02						
		Amounts Recovered from Unconsolidated Entities							
	5.4	Hydro (Principal)	PL 12 55 01						
	5.5	Hydro (Interest)	PL 12 55 02						
	5.6	Gas and Telephone (Principal)	PL 12 57 01						
	5.7	Gas and Telephone (Interest)	PL 12 57 02						
	5.8	SUBTOTAL	Add lines 5.1 thru 5.7						
6.0		PAYMENTS TO PROVINCE FOR DOWNTOWN REVITALIZATION PROGRAM LOANS	PL 08 81 08						
7.0		DEBT CHARGES FOR TILE DRAINAGE AND SHORELINE ASSISTANCE	PL 08 45 02						
8.0		**SUBTOTAL - DEBT CHARGES TO BE EXCLUDED**	**Add lines 5.8, 6.0, 7.0**						
9.0		**NET DEBT CHARGES**							
10.0		TOTAL REVENUE FUND REVENUES	PL 03 51 04						
11.0		FEES FOR REPAYING THE PROVINCE FOR DOWNTOWN REVITALIZATION	PL 08 81 08						
12.0		FEES FOR TILE DRAINAGE AND SHORELINE ASSISTANCE	PL 07 45 04						
13.0		GRANTS FROM GOVERNMENT OF ONTARIO, GOVERNMENT OF CANADA AND OTHER MUNICIPALITIES							
	13.1	Ontario Grants	PL 03 69 04 + PL 03 29 04						
	13.2	Canada Grants	PL 03 30 04						
	13.3	Other Municipalities	PL 03 31 04						
	13.4	SUBTOTAL	Add lines 13.1 thru 13.3						
14.0		CONTRIBUTIONS FROM CAPITAL FUND	PL 03 43 04						
15.0		CONTRIBUTIONS FROM RESERVES AND RESERVE FUNDS	PL 03 44 04						
16.0		FEES AND REVENUE FROM OTHER MUNICIPALITIES FOR JOINT LOCAL BOARDS							
17.0		**NET REVENUE FUND REVENUES**	**Line 10 less lines 11, 12, 13.4, 14, 15, 16**						
18.0		**25% OF NET REVENUE FUND REVENUE**							
19.0		**ANNUAL REPAYMENT LIMIT** **25% of Net Revenue Fund Revenues less Net Debt Charges**							

Remaining Capacity would support additional debenture debt issued in the amount of ($ Millions)

FIGURE 4-13

CAPITAL BUDGET DOCUMENT

CAPITAL IMPACT ON OPERATING ANALYSIS

	CURRENT YEAR	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
OPERATING CONTRIBUTIONS TO CAPITAL FUNDING:						
TO CAPITAL						
TO RESERVES						
TO RESERVE FUNDS						
DEBENTURE DEBT:						
EXISTING DEBT CHARGES						
NEW DEBT CHARGES						
TOTAL DEBT CHARGES						
ESTIMATED ANNUAL CAPITAL CONTRIBUTION						
NET CHANGE YEAR-OVER-YEAR - $						
ESTIMATED CUMULATIVE IMPACT - $						
NET ANNUAL BASE OPERATING BUDGET PROJECTION - %						
- $						
INCREASE/DECREASE IN OPERATING BUDGET AS A RESULT OF PROJECTS						
Project 1						
Project 2						
etc. ...						
TOTAL OPERATING BUDGET (Incl. increase in Capital)						
INCREASE IN TAXES GENERATED THROUGH ASSESSMENT - %						
ADDITIONAL TAXES GENERATED - $						
TOTAL PROJECTED IMPACT ON OPERATIONS:						
NET CHANGE YEAR-OVER-YEAR - $						
ESTIMATED TAX RATE IMPACT - %						
ESTIMATED CUMULATIVE IMPACT - $						
ESTIMATED CUMULATIVE AVG IMPACT - %						

NOTES:

In order to reduce the tax impact in Year 1 by 1%:

Defer or refinance	Tax Levy Funding
Defer or refinance	Debenture Debt Funding

5. DEBT MANAGEMENT

5. DEBT MANAGEMENT

5.1 OVERVIEW

Debt management may be defined as the process of providing for the payment of interest and principal payments on existing debt, and the planning for incurrence of new debt at a level which will optimize borrowing costs and not impair the financial position of the municipality.

At the municipal level, debt management is the blending of the capital and current budgets. More specifically, it is the projection of the capital budget's impact on the operating budget in future years.

The debt position of a municipality is of interest to the Provincial government and potential purchasers of the municipality's debentures. The Ministry of Municipal Affairs and Housing regulates that a municipality should not commit more than 25% of total own purpose revenue to service debt and other long term obligations without obtaining prior OMB approval. Annually, municipalities submit data on their long-term liabilities and debt charges to the Province (via the annual Financial Information Returns). This information forms the basis for the calculation of an upper limit of future debt to be incurred.

Investors look to credit rating agencies for an assessment of a municipality's credit worthiness. A number of key indicators are used to assess a municipality's ability to service debt. Some of the most commonly used indicators are shown below (the reader should consult the criteria provided by the credit rating agencies directly for more detail):

i) Debt per capita
ii) Debt charges per capita
iii) Debt charges as a percentage of revenue
iv) Debt charges as a percentage of the municipal levy
v) Debt to assessment ratio
vi) Debt charges to tax rate ratio
vii) Annual increase in debt in relation to:
    a) inflation
    b) population

c) assessment growth
d) operating revenue

These indicators are reviewed on their own merit, and in relation to other municipalities, to derive the municipality's credit worthiness (the potential risk of the municipality not meeting debt payment obligations). Determination of credit worthiness is reflected by the interest rate at which the investor is willing to lend his money. The ability to repay debt and a sound financial position lowers the overall risk to an investor, and therefore, lowers the interest rate required by the investor. In theory, the ultimate debt capacity of a municipality is the point at which no investor will make money available to the municipality at any rate of interest.

5.2 GUIDELINES - ANNUAL REPAYMENT LIMIT CALCULATION

The Ministry of Municipal Affairs and Housing regulates the level of debt incurred by Ontario municipalities. This task was formerly undertaken by the Ontario Municipal Board but, as of 1993, has been the responsibility of the Ministry. The Ministry regulates the debt by regulation through its powers established in the *Municipal Act*. Ontario Regulation 799/94, as amended by 75/97 (a copy of these regulations is provided in Appendix C) provides the current rules respecting municipal debt and financial obligations.

Schedule 5-1 provides the detailed calculations which the Ministry undertakes annually based upon the Financial Information Returns (FIR's) submitted by each municipality. The reference to the financial information return is denoted on the schedule as "PL 03 29 04" which refers to the page number, the line and column from the FIR.

The calculations generally provide the following:

A. Gross Debt Charges Paid by Municipality

B. ADD: - Provincial Sewer and Water Related Agreements (OCWA)
  - Payments Toward Long Term Commitments/Liabilities

C. Add: - Payments Related to Debt Issued on Behalf of Related Utility Commissions

- Payments on Behalf of Landowners (Tile Drainage, Downtown Revitalization, Shoreline Debt)

D. Net Debt Charges [(A + B) - C]

E. Total Revenue Fund Revenues

F. Add
  - Payments made by landowners related to Tile Drainage, Downtown Revitalization, Shoreline debt
  - Grants and Subsidies from Senior Levels of Government
  - Revenues from Local Joint Boards
  - Contributions from the Capital Fund, Reserves and Reserve Funds

G. Net Revenue Fund Revenues (E - F)

From the above, the municipality's existing debt levels are calculated by dividing D by G (Net Debt charges divided by Net Revenues). This percentage is the existing debt used to date. The remaining debt limit (how much additional debt charges can be incurred and remain within the guideline) is calculated as follows:

G X 25% – D = remaining debt limit

The amount of debt and other long-term financial obligations which can be entered into and allow the municipality to remain within its debt limit, will vary depending upon the interest rate and the term of the debt issued and the terms and conditions of the long-term financial obligations. Generally, the larger the annual payments respecting debt or other financial obligations (for example high interest rate and shorter) the less the debt or other financial obligations which can be entered into while remaining within the debt limit. The debt limit is established on the basis of the annual debt repayment amount, not on the principal amount of the debt issued or total value of long-term financial obligations entered into. At the bottom of the third page of Schedule 5-1, the Ministry provides an example calculation of how much additional debt may be issued based upon assumptions of debt issued at 10.5% interest, over 5, 10, 15 and 20 year terms.

The annual debt repayment limit calculation is sent to municipalities by the Ministry at the beginning of every year. However, these calculations are based on data from the latest FIR submitted which is dated (for example for 1999, the calculations were based on 1997 FIR information). Although the Ministry reviews and regulates the debt levels of a municipality, it is still the responsibility of the municipality to calculate whether it is within its limit. The municipal Treasurer is required to update the limit prior to Council approval of a capital project which requires long term borrowing. Debt capacity calculations have been provided as part of the analysis schedules provided in Chapter 4 and debt monitoring should be undertaken annually as part of the capital budgeting process.

SCHEDULE 5-1

Ministry of Municipal Affairs	**Ministère Affaires Muncipales**
and Housing	**et du Logement**
777 Bay Street,	**777 rue Bay**
Toronto, Ontario	**Toronto, Ontario**
M5G 2E5	**M5G 2E5**

ANNUAL REPAYMENT LIMIT
UNDER ONTARIO REGULATION 799/94
00-JAN-00

MMA CODE:

MUNID:

MUNICIPALITY:

UPPER TIER:

REPAYMENT LIMIT:

The repayment limit has been calculated based on data contained in the 1994 Financial Information Return, submitted to the Ministry. This limit represents the maximum amount which the municipality had available as at December 31, 1998 to commit to payments relating to debt and financial obligations. Prior to the authorization by council of a long term debt or financial obligation, this limit must be adjusted by the treasurer in the prescribed manner. The limit is effective January 01, 2000.

FOR ILLUSTRATION PURPOSES ONLY, the additional long-term borrowing which a municipality could undertake over a 5-year, a 10-year, a 15-year and a 20-year period is shown.

DETERMINATION OF ANNUAL DEBT REPAYMENT LIMIT
00-JAN-00

MUNICIPALITY: **MMA CODE:**

1. GROSS DEBT CHARGES		
1.1 Principal		Pl 12 78 01
1.2 Interest		Pl 12 78 02
1.3 SUBTOTAL	**Add Lines 1.1,1.2**	
2. DEBT CHARGES ON O.C.W.A. PROVINCIAL PROJECT		
2.1 Water Projects -- this municipality only		Pl 12 46 03
2.2 Water Projects -- share of integrated project(s)		Pl 12 47 03
2.3 Sewer Projects -- this municipality only		Pl 12 48 03
2.4 Sewer Projects -- share of integrated project(s)		Pl 12 49 03
2.5 SUBTOTAL	**Add Lines 2.1 thru 2.4**	
3. PAYMENTS IN RESPECT OF LONG TERM COMMITMENTS AND LIABILITIES		Pl 08 73 08
4. SUBTOTAL - DEBT CHARGES	**Add Lines 1.3,2.5,3.0**	
5. DEBT CHARGES FOR MUNICIPAL UTILITIES		
5.1 Electricity		Pl 08 48 02
5.2 Gas		Pl 08 49 02
5.3 Telephone		Pl 08 50 02
Amounts Recovered from Unconsolidated Entities		
5.4 Hydro (Principal)		Pl 12 55 01
5.5 Hydro (Interest)		Pl 12 55 02
5.6 Gas and Telephone (Principal)		Pl 12 57 01
5.7 Gas and Telephone (Interest)		Pl 12 57 02
5.8 SUBTOTAL	**Add Lines 5.1 thru 5.7**	
6. PAYMENTS TO PROVINCE FOR DOWNTOWN REVITALIZATION PROGRAM LOANS		Pl 08 81 08
7. DEBT CHARGES FOR TILE DRAINAGE AND SHORELINE ASSISTANCE		Pl 08 45 02
8. SUBTOTAL - DEBT CHARGES TO BE EXCLUDED	**Add Lines 5.8,6,7**	
9. NET DEBT CHARGES	**Line 4 less Line 8**	

DETERMINATION OF ANNUAL DEBT REPAYMENT LIMIT
00-JAN-00

MUNICIPALITY: **MMA CODE:**

10. TOTAL REVENUE FUND REVENUES		Pl 03 51 04
11. FEES FOR REPAYING THE PROVINCE FOR DOWNTOWN REVITALIZATION LOANS		Pl 08 81 08
12. FEES FOR TILE DRAINAGE AND SHORELINE ASSISTANCE		Pl 07 45 04
13. GRANTS FROM GOVERNMENT OF ONTARIO, GOVERNMENT OF CANADA AND OTHER MUNICIPALITIES		
13.1 Ontario Grants		PL 03 69 04 + PL 03 29 04
13.2 Canada Grants		Pl 03 30 04
13.3 Other Municipalities		Pl 03 31 04
13.4 SUBTOTAL	**Add Lines 13.1 thru 13.3**	
14. CONTRIBUTIONS FROM CAPITAL FUND		Pl 03 43 04
15. CONTRIBUTIONS FROM RESERVES AND RESERVE FUNDS		P 03 44 04
16. FEES AND REVENUE FROM OTHER MUNICIPALITIES FOR JOINT LOCAL BOARDS		
17. NET REVENUE FUND REVENUES	**Line 10 less Lines 11,12,13.4,14,15,16**	
18. 25% OF NET REVENUE FUND REVENUES		
19. ANNUAL REPAYMENT LIMIT **25% of Net Revenue Fund Revenues less Net Debt Charges**		

FOR ILLUSTRATION PURPOSES ONLY

If the municipality could borrow at 10.5% annually, the annual repayment limit shown in 19 above would allow it to undertake additional long-term borrowing as follows:

a) 20 years @ 10.5% p.a.
b) 15 years @ 10.5% p.a.
c) 10 years @ 10.5% p.a.
d) 5 years @ 10.5% p.a.

5.3 DEBT MANAGEMENT - LONG-TERM DEBT[1] VS. PAY-AS-YOU-GO

After the second world war, municipalities sought to expand their infrastructure and used debt financing as the vehicle to finance these expenditures. Until the 1960's, much of the capital infrastructure constructed depended on debt financing and the cost of borrowing was relatively inexpensive. During the 1970's, there was a general movement in the municipal sector to reduce the level of dependency on long-term debt financing. This movement was reinforced during the latter part of the decade when interest rates rose to all time high levels and were sustained for several years. Today, most major municipalities in Canada practise a combination of long-term financing and pay-as-you-go policies.

There are mixed views as to whether long-term debt financing is a superior method of capital financing than pay-as-you-go. There are advantages and disadvantages to both approaches, municipalities need to consider the merits of both methods to guide their future financing in accordance with a long term plan. In doing so, municipalities should establish parameters to guide the financing of their capital budgets, and develop policies to implement these guidelines.

Some of the major benefits derived from long-term debt financing are as follows:

1. For assets with a longer life expectancy, the payments are spread over a longer term.
2. Debenture-financing smooths the impact on the operating budget.
3. It allows more projects to be constructed simultaneously during a period of rapidly expanding growth and assessment.
4. During periods of increasing inflation, it may reduce the real cost of the project.
5. It is the best financial tool for handling emergency situations.

Some of the positive attributes of a pay-as-you-go policy are:

---

[1] Long-term debt includes: long-term borrowing, issuance of debentures, capital leases, and other forms of long-term financial obligations.

1. The financial consequences of capital spending are faced as spending decisions are being made.

2. Paying for capital costs up-front encourages a realistic level of spending.

3. Greater Operating Budget flexibility is preserved for the future.

4. Increased financial strength.

5. Future generations inherit paid-up facilities.

6. Interest payments, fiscal agent fees, and debenture issuance costs avoided.

7. During periods of declining interest rates, debt financing increases the real cost of the project.

Once debenturing forms a significant portion of a municipality's capital financing, the potential financial impact on the Operating Budget in the early years of moving to a pay-as-you-go policy can be a major stumbling block to its implementation. Pay-as-you-go may be implemented by increasing the Operating Budget in one year to a level sufficient to pay all capital expenditures for that year. However, this approach is likely to have a very significant impact on tax rates in its first year.

Alternatively, pay-as-you-go may be achieved by a gradual phasing out of debenture financing in the capital spending program. This may be implemented by using a three phase plan as described below as one possible approach:

- Phase I allows for a gradual increase in the contribution to capital from the operating budget and for the gradual establishment of reserve funds. During this phase, the annual debenture requirements (and resulting annual debt charges) are on the decline.

- Phase II can commence once the reserves have increased to a sustainable level. Annual capital expenditures, net of the Operating Budget contributions, can now be met from reserve contributions without the need for external debentures. This phase introduces internal debt financing, utilizing a revolving reserve fund. Annual contributions to the reserves are similar to annual repayment of external debt, and can be achieved through planned multi-year operating budgets.

- Phase III commences once the amount budgeted for repayment to the reserves equals or exceeds the actual net capital budget requirement. At this point, the current contribution to capital plus the internal debt repayment equal the net internal financing requirement of the capital budget. Internal debt repayment can be discontinued as the total net capital budget can be accommodated through direct contributions from the operating budget.

The decision to use debt (including capital leases or other forms of long-term financial obligations) or pay-as-you-go financing is a local decision of the municipality. The policy selected may vary from program to program (e.g. use of pay-as-you-go for infrastructure replacement projects; use of debt financing for growth projects or cost saving projects). Either method may be beneficial to individual municipalities in certain circumstances; however, the long term financial impact of the approach taken needs to be evaluated by the municipality prior to making these decisions.

In general, in a low debt, low interest rate, and low inflation environment, debenture financing or other forms of long-term financial arrangements may be attractive mechanisms to use to finance capital projects for which there is a pressing need.

6. LONG TERM IMPACT

6. LONG TERM IMPACT

As discussed in previous chapters, the essential elements of a capital budget are to identify the gross capital expenditures, and to identify and subtract all external revenues to calculate the net cost to the municipality. The net capital cost can then be financed through several alternative sources, such as reserves, the sale of assets, direct capital contributions from the operating budget, or the issuance of debt or other long-term financing.

If reserves[2] have been established in past years and remain uncommitted, these funds may be allocated to reduce the net long-term financial commitments requirement. Reserves represent surpluses generated in past years which have been set aside for future use, or they may have been established for a special purpose.

In general, the remaining options for funding the capital expenditures are to provide capital contributions from the operating budget, or to debenture finance the projects and repay debt charges in future years. A simple five year operating budget projection, using the capital financing sources discussed above is illustrated below:

FIVE YEAR OPERATING BUDGET ANALYSIS					
	YEAR				
	1	2	3	4	5
1. Operating Expenditures (net of capital) 2. Existing Debt Charges 3. New Debt Charges 4. Capital from Current 5. Increase/Decrease in Operating Expenditures Arising from New Capital Projects					
Annual % Increase		%	%	%	%

---

[2] See Appendix D for more detail on reserves and reserve funds.

The operating expenditures (line 1) represent the total operating cost of providing services for the various municipal programs. Operating expenditures include salaries, wages, benefits, materials, supplies, service contracts, etc. They are the day-to-day expenditures of the municipality. If, for example, it is assumed that the service level of various municipal services remain constant, expenditures would probably increase with inflation (salary adjustments, increase cost of benefits, material, supplies, etc.). Consideration of the potential increases and decreases the municipality may experience over time should be provided by a detailed analysis of factors influencing future operating expenditures.

Line 2 represents the debt charges for debentures issued in prior years. These charges are actual existing obligations to pay and do not change.

Lines 3, 4 and 5 are sources of financing dependent upon the capital budget which council is to consider.

Lines 3 and 4 are interdependent and will vary inversely with a change in one or the other. For example, if the total debt charges (Line 2 and Line 3) exceed the provincial debt guidelines and it is not possible to obtain OMB approval, more transfers from the operating budget may be required to reduce future additional debt charges. Conversely, if the total current budget increase is too high, the transfers may have to be reduced, thereby increasing future additional debt charges. Consideration may also be given to reducing the forecast capital expenditures by eliminating or deferring capital works.

The last line represents the future increase or decrease in operating expenditures arising from construction of the budgeted works. For example, increases in operating costs would result from the construction of a sewage treatment plant that requires annual expenditures for labour, supplies, utilities, etc. Decreases in operating expenditures may be achieved by the construction of cost-saving works (e.g. insulating an existing building which will save fuel costs in future years).

Depicting the total operating budget forecast graphically (Figure 6-1) provides an insight into the mechanisms at play. The graph has been extended out over 10 years to enable better visualization of the components of the budget.

The first section represents the existing debt charges that must be paid in future years. This line illustrates decisions made by past councils that the present and future taxpayers must pay. Existing debt charges within a current budget represent fixed charges which cannot be changed until the debt is repaid. It is important to note that if municipal corporations were dissolved and no services were provided, the debt charges would still result in taxes until all obligations were met.

The second section of the graph represents a capital budget decision made by council. When council approves the construction of capital projects and decides that these projects will be funded by the issuance of debt, then council makes a commitment that future debt servicing costs (and potentially other related operating costs) will be financed from future years' operating budgets; thereby reducing the degree of future financial flexibility for the municipality. Council needs to be aware of the future impact of these decisions at the time they are made.

Section three of the graph is the contribution made from the operating budget to fund capital works. This contribution represents the upfront funding of the construction of capital works or, in other words, capital spending decisions made by the existing council are being paid for by the existing taxpayers. As stated earlier, this line, and the anticipated Debt Line, are interdependent. At current debt issuance rates, there is approximately a 7 to 1 ratio between these two sections. In order to reduce the anticipated debt line by $1 in future years, you must contribute $7 to fund capital expenditures today. (The amortization factor for debt issued at 6% over 10 years is .135867.)

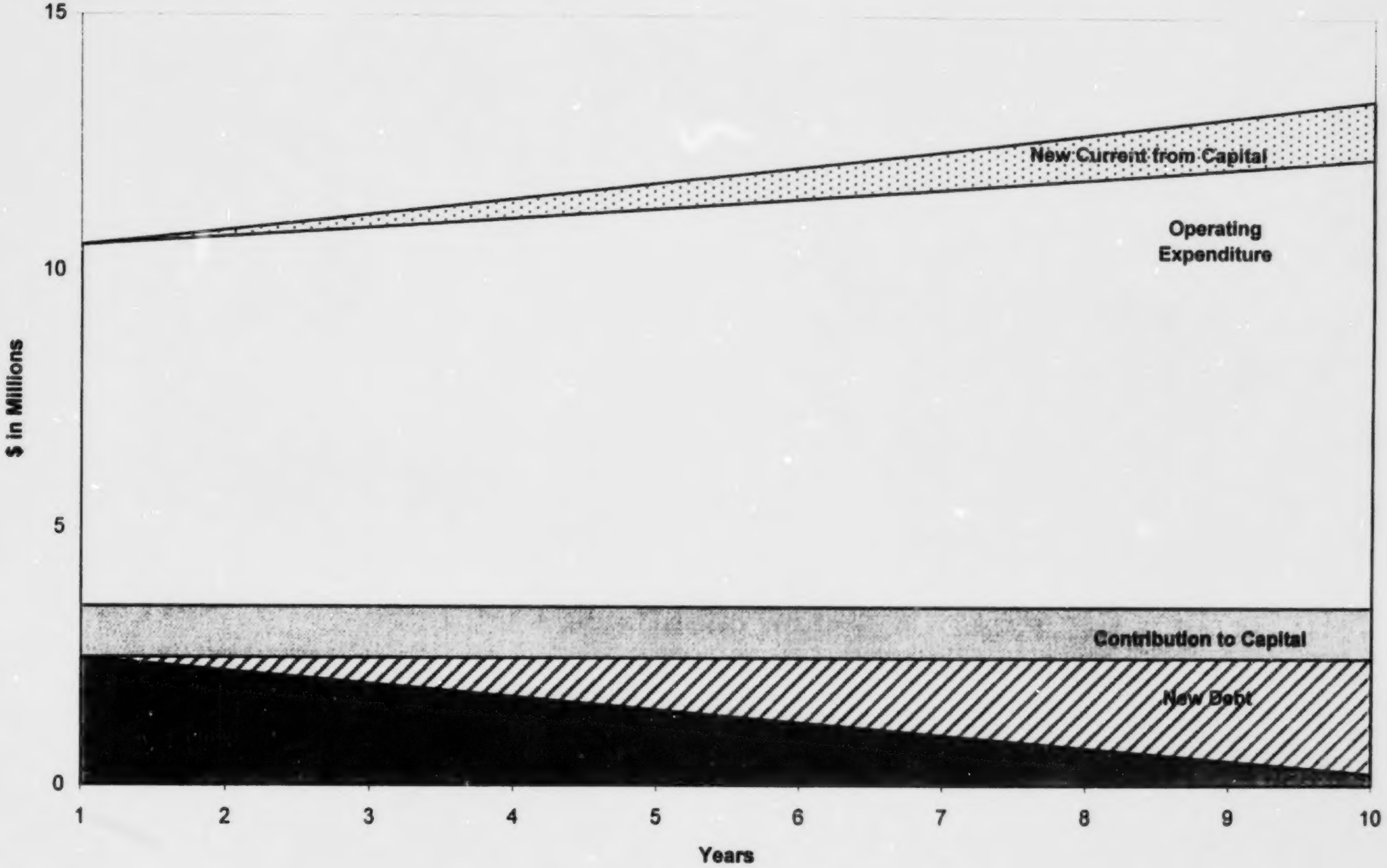
The operating expenditure area of the graph represents all associated costs for administration, day-to-day maintenance, utilities, salary and wages, etc., for municipal services. The annual operating budgets approved by council indicate the level of services that will be provided. In most cases, these costs may be adjusted annually at or about the rate of inflation unless there is an increase or decrease in services.

The last section, operating costs arising from new capital projects, represents the increase in operating expenditures that result from the construction of new capital works. As in the earlier example, if a new sewage treatment plant were to be constructed, funds would have to be provided to pay for salary costs, utility costs, materials, etc.

Specific policies should be developed by council in order to control future debt levels, and the future impact on the tax rate/ratepayer. As discussed earlier, there are portions of the operating budget over which a sitting council may have very limited decision-making authority. When a council reviews the operating budget, it must take into consideration (financially) the decisions of past councils (i.e. existing debt charges, increase in operating expenditures for newly completed capital works). Similarly, when council approves a capital budget and the associated financing of that budget, the full impact of those decisions may not show up immediately in the financial transactions until future debt charges and new operating costs associated with new capital projects are recorded.

A multi-year capital forecast and long term financial policy are important financial tools that municipalities can use to manage changes in present and future budget requirements and to ensure affordability over the long term.

FIGURE 6-1
TEN YEAR OPERATING BUDGET



7. CAPITAL BUDGET MAINTENANCE

7. CAPITAL BUDGET MAINTENANCE

7.1 WORK-IN-PROGRESS MONITORING

After council has approved the capital budget (including its financing) for the current year, work can be initiated on the approved projects. Alternatively, if a cash flow method of capital budgeting has been adopted, work on the approved phases of projects can start. The approved funding from various sources can be transferred to individual project accounts in the capital fund. A common practice is to time the transfer of approved funding from internal sources such as operations, reserves, or reserve funds at mid-year. This ensures that interest will continue to be earned in the reserve fund until the project has been initiated and payments from the project have begun to be made.

The capital fund differs from the general municipal operations fund in that capital projects may be ongoing for a number of years, hence the adoption of the term capital "work-in-progress". Individual accounts in the capital fund may not be "closed" at the year end financial reporting cycle as are those in the operating fund. The accounts in the operating fund are closed annually to show an operating surplus or deficit. In-year expenditures and revenues in the capital fund are reported in each fiscal year as discussed in section 7.3 below. The status of projects will be reviewed periodically (at least once per year) and projects that have been completed will be closed. This process is discussed in section 7.2 below.

Ongoing monitoring of the capital work-in-progress accounts is a very important function since the expenditures taking place through this fund usually represent a significant portion of the municipality's total expenditures for a fiscal year. Responsibility for monitoring project accounts is shared by the department responsible for managing the project and by the Finance or Treasury department. The department managing the project oversees the progress of the project to completion to ensure the project is completed in accordance with municipal standards and is also completed on time and within budgetary allocation. The Finance or Treasury department verifies the project status with the managing department as the project proceeds and directly monitors expenditures against the accounts to ensure that they are within approved budget limits. Status reports should be prepared periodically for council to keep them up-to-date with the progress of various projects and to obtain approval for any amendments to financing that may be required.

As discussed in Chapter 3, the Finance or Treasury department together with the managing department are responsible for reviewing the status of capital work-in-progress accounts on an annual basis during the budget preparation process. During this review it is important to ensure that the status of actual expenditures to date is still in line with the approved budget. Any revisions to the timing or gross cost of the project need to be considered when the municipal budget is approved for the upcoming year.

7.2 CLOSURE OF COMPLETED PROJECTS

When the status of capital projects is reviewed periodically, completed capital projects should be identified so that they may be closed in the municipality's records. Projects are complete when the final payments or expenditures have all been processed. Actual expenditures against a project cannot be expected to match exactly with the approved budget estimate or financing that has been allocated to the project. As projects are identified for closure, some will be over expended and some will be under expended. If the ongoing project monitoring process is undertaken effectively, budget to actual shortfalls should be addressed and refinanced on an ongoing basis. Therefore, ideally, council should have very few funding shortfalls to address at the time of project closure. However, any significant funding shortfalls that do exist should be identified and reported to council for approval.

Project closure is a process that should be undertaken periodically (at least once per fiscal year) so that a number of projects may be closed at the same time. Council should establish a policy to determine an acceptable process that can be followed for the closing of capital projects' accounts. The closing of accounts can then be delegated to staff and council will be informed of the closings through regular project status reports.

When a capital project account is closed, the financing must match the final expenditures incurred. Therefore, additional financing must be provided to projects that are slightly "over" budget, and alternatively, financing may be returned to its original source(s) for projects that have been slightly "under" budget. In accordance with established council policy, for small variances, funding can be applied from or returned to its original sources in the same proportion as the approved budget. Municipalities often use an unallocated capital reserve to provide a source of funding for project closure purposes. A separate reserve should be used for tax levy versus user rate financing.

7.3 FINANCIAL REPORTING/AUDIT REQUIREMENTS

As stated in section 7.1, accounts in the capital fund may not closed on annual basis as capital projects may span over a period of several years. However, capital expenditures and revenues constitute a significant portion of the total expenditures and revenues of a municipality and are, therefore, an important factor to be considered during the municipality's annual financial reporting process. All expenditures from the capital fund, external revenues received, internal fund transfers and changes in position of capital assets and liabilities (i.e. outstanding debenture debt), incurred during each fiscal year are summarized and accounted for during the preparation of the municipality's year end financial statements and the completion of the annual Financial Information Return (FIR). The municipality's accounting system must be capable of separating financial transactions, incurred for projects during the current fiscal year, from capital transactions incurred in previous fiscal periods.

The municipal audit firm is responsible for providing their professional assurance that the current year revenues and expenditures and the financial position of the municipality are accurately reflected in the annual financial statements that are issued. With this objective in mind, they will conduct an examination of the financial accounting systems and procedures, and the financial records of the municipality in order to verify the accuracy, consistency and integrity of the information being used in preparing of the financial statements.

Verifying the municipality's transactions in the capital fund is an important part of any audit. The following are a number of the key capital related items which will normally be verified during an annual audit although there may be some variation between municipalities:

- the approved annual capital budget will be verified back to the budget approved by council;
- all significant funding transfers will be verified and balanced back to authorizing documentation, such as an approved budget or a separate approval by council;
- all associated documentation will be reviewed and verified for all individual large transactions (in excess of a specified amount), and the impact of the transaction on the statements will be confirmed;

- all associated documentation will be reviewed and verified for all other capital fund transactions on a sample basis to confirm their impact has been appropriately reported on the financial statements;
- actual expenditures for projects will be verified against the approved budgets and any significant variances to budget will be investigated;
- any projects remaining in a significant unfinanced net position at year end will be investigated; and
- material changes in capital fund assets (i.e. significant receivables) and capital fund liabilities (i.e. debenture debt) will be reviewed and verified to provide assurance that the financial position of the municipality is accurately reflected.

8. CONCLUDING REMARKS

8. CONCLUDING REMARKS

Capital budgeting is an essential part of the municipal financial planning and management process. It helps municipalities to forecast their future financial position and to implement longer range policy documents such as official plans, strategic plans and master plans. Long range financial planning enables municipalities to define the direction they will take over the short and medium terms and ensures that service levels and tax levels are well managed.

Through capital budgeting, municipalities can plan future operating budget expenditure, debt repayment and potential reserve fund needs in order to manage the financial position of a municipality over a five to ten year period. It is also the process which prioritizes and shows the financial implications of implementing new and replacement infrastructure and other capital projects.

The overview of the capital budgeting process and guidelines contained in this manual are designed to assist municipalities in developing a structured approach to capital budgeting as they acquire greater responsibility in local service delivery. It is hoped that this document will equip municipalities with the tools they need to establish and enhance their capital budgets so that they are better able to address local needs.

As noted earlier, the guidelines contained in this document reflect the current capital budgeting framework. The contents of this handbook will therefore be affected by anticipated legislative changes in the areas of capital financing and debt management. These changes should be monitored and incorporated into future capital planning to ensure compliance with provincial guidelines.

A number of publications and other sources have been appended to this handbook, which provide further insights into the capital budget and other financial practices. Municipalities may also contact the AMCTO, the MFOA, the GFOA or their local Municipal Services Office for further assistance.

APPENDIX A

GLOSSARY OF TERMS

APPENDIX A

Glossary of Terms

Accounting Period	A period at the end of which and for which financial statements are prepared. Also Fiscal Period. In the case of the Ontario municipalities, this period ends on December 31st of every year.
Annual Budget	A budget applicable to a single fiscal year for each Municipality.
Budget	A plan of financial operations embodying an estimate of proposed expenditures for a given period and the proposed means of financing them.
Current Budget	The annual budget prepared for and effective during the present fiscal year for the Revenue Fund.
Capital Budget	A plan of proposed capital fund expenditures and the means of financing them from the current fiscal period and over a longer term planning horizon.
Capital Program	A plan for capital expenditures to be incurred each year over a fixed period of years to meet capital needs arising from the long term work program.
Capital Fund	The capital fund is used to accumulate the revenues and expenditures for the acquisition of or repair and replacement of the capital assets of the municipality. In general, capital assets refer to the building, equipment and infrastructure of the municipality. Included are municipal buildings, arenas, trucks, graders, roads, water/sewer systems and the like.
Current (Operating) Funds	see "Revenue Fund"

Current Taxes	(1) Taxes levied and becoming due during the current fiscal period, from the time the amount of the tax levy is first established to the date on which a penalty for non-payment is attached. (2) Taxes levied in the preceding fiscal period but becoming due in the current fiscal period.
Debenture	A written promise to pay a specified sum of money called the face value or principal amount at a specified date or dates in future, called maturity dates, together with periodic interest at a specified rate.
Debt	An obligation resulting from the borrowing of money or for the purchase of goods and services.
Debt Limit	Maximum amount of gross or net municipal debt permitted without OMB approval as regulated by the Province.
Debt Charges	Annual charges required to service the long term debt of a municipality including an amount for principal repayments, interest due within the year, and required sinking fund contributions.
Debt Term	The borrowing term of all long-term debt incurred by a municipality is always equal to or less than the estimated life of the assets being financed. In general, borrowing does not exceed 20 years. However, beginning in 1980, councils have attempted, where possible, to limit all debenture terms for debenture purposes to no more than ten years.
Debt Retirement	Long-term debt is retired at final maturity through serial retirements.
Fund	An independent fiscal and accounting entity with a self balancing set of accounts segregated for the purpose of carrying on specific activities. There are three funds; the Revenue Fund, Capital Fund and the Reserve Fund.

Pay-As-You-Go	The term is used to describe the financial policy whereby capital outlays are financed from current revenues and/or reserves rather than by debt.
Reserve Fund	Reserve funds are those funds that have been set aside either by a by-law of the council or by a requirement of provincial legislation to meet a future event. As a result, reserve funds are either "permissive" being those set up by council or "regulatory" being those set up by virtue of a requirement of a provincial statute. Municipal councils may set up reserve funds for any purpose for which they have the authority to spend money.
Revenue Fund (also referred to as the Current or Operating Fund)	The revenue fund or the "operating" or "general fund" as it is often called, is the principal fund, found in all municipalities. This is the fund into which the main sources of financing available to the municipality are recorded. Taxation revenue, grants, interest earned on investments, service charges, licenses and permits are all recorded in this fund. It is also the fund that records disbursements for the everyday operating expenditures of the municipality.

APPENDIX B

EXAMPLES OF CAPITAL BUDGET FORMS, REPORTS, PROCESSES AND POLICIES USED BY ONTARIO MUNICIPALITIES

During the preparation of the handbook, the Committee reviewed the undermentioned documents. These documents can be obtained from the AMCTO and MFOA, and they may be contacted through their respective web sites: www.amcto.com and www.mfoa.on.ca . The documents may also be obtained by contacting the relevant municipality.

1 Capital Budget Process - Brockville

2 Project Information Sheet - Orangeville

3 Priority Ranking - Milton

4 Capital Budget Summary - Nepean

5 Capital Budget Council Report - Belleville

6 Letter of Transmittal to Capital Budget - Haldimand-Norfolk Region

7 Capital Budget Financial Policy - Kitchener

8 Capital Financing and Debt Policy - York Region

9 Monthly Budget Variance Reporting Summary - New Tecumseth

APPENDIX C

ONTARIO REGULATION 799/94
DEBT AND FINANCIAL OBLIGATIONS LIMITS

This text is an unofficial version of extracts from Ontario legislation or regulations (updated to October, 1999) included for the purpose of convenience only. For accurate and more complete reference recourse should be had to the official volumes.

O. Reg. 799/94 -- DEBT AND FINANCIAL OBLIGATION LIMITS

1. (1) The annual debt and financial obligation limit for municipalities shall be determined under this Regulation.

(2) The Ministry shall annually determine the limit using the formula described in section 3 based on the financial information supplied to the Ministry by each municipality under the Act and under the Municipal Affairs Act.

(3) The Ministry shall inform the treasurer of the municipality in writing of the limit.

2. A municipality shall use the most recent limit provided to it by the Ministry to determine whether Ontario Municipal Board approval is required in respect of the following categories of debt or financial obligation:

1. Long-term debt assumed by a municipality for which repayment will be required beyond the term for which the council was elected.
2. Other financial commitments, liabilities and contractual obligations, for which payment may or will be required beyond the term for which the council was elected, including financial commitments to hospitals and universities.

3. The Ministry shall determine the debt and financial obligation limit of a municipality as follows:

1. Calculate the revenue fund revenues for a past fiscal year, excluding amounts received in the year,
    - i. as grants from the Government of Ontario or Canada or from another municipality,
    - ii. as proceeds from the sale of real property,
    - iii. as a contribution or transfer from a reserve, reserve fund or capital fund,
    - iv. under agreement with the Government of Ontario, for the purpose of repaying the principal and interest of long-term debt or meeting financial obligations of the municipality,

v. from another municipality or a school board for the repayment of the principal and interest of long-term debt of the municipality borrowed for the exclusive purposes of the other municipality or school board,
vi. as revenues from electrical, telephone and gas service,
vii. as revenues for the purpose of repaying the principal and interest of debt under the Tile Drainage Act or the Shoreline Property Assistance Act, and
viii. as revenues for the purpose of repaying the principal and interest of debt with respect to the downtown revitalization loan program.

2. Multiply the amount obtained in paragraph 1 by 25 per cent.

3. Subtract from the amount obtained in paragraph 2 the total payments in the fiscal year related to the long-term debt of the municipality less,
i. the payments in that year for long-term debt or financial obligations for which the Government of Ontario has agreed to provide to the municipality the amounts required by the municipality to repay the principal and interest of the debt or to meet the financial obligations,
ii. payments in that year from another municipality or a school board for the repayment of the principal and interest of long-term debt of the municipality borrowed for the exclusive purposes of the other municipality or school board,
iii. the payments for electrical, telephone and gas service provided by the municipality for which revenues are received by the municipality in that year,
iv. the payments for shoreline assistance and tile drainage in that year, and
v. the payments made respecting the downtown revitalization loan program in that year,

4. Subtract from the amount obtained in paragraph 3 payments made in the fiscal year in respect of the financial commitments, obligations and liabilities described in paragraph 2 of section 2.

4. (1) Before authorizing any specific work or class of work or any increase in expenditure for a previously authorized specific work or class of work that would require a long-term debt or financial obligation described in section 2, the council of the municipality shall have its treasurer calculate an updated limit using the most recent debt and financial obligation limit determined by the Ministry. O. Reg. 799/94, s.

4(1); O. Reg. 75/97, s. 1(1).

(2) The treasurer shall update the most recent limit determined by the Ministry as follows:

1. Adjust the limit in respect of the estimated annual amount payable for any long-term debt or financial obligation described in section 2 assumed or discharged by the municipality since the last day of the past fiscal year for which the limit was calculated.
2. Subtract from the amount obtained in paragraph 1, the estimated annual amount payable in respect of any project approved by the Ontario Municipal Board or the council, as the case may be, to be financed by long-term debt or financial obligation described in section 2 but not as yet assumed unless council has, by resolution, indicated that it will not proceed with that project.
3. Subtract from the amount obtained in paragraph 1 any amount recognized by the treasurer as annually payable or as payable in the year in respect of a financial obligation described in paragraph 2 of section 2.

O. Reg. 799/94, s. 4(2).

(3) The treasurer shall calculate the estimated annual amount payable by the municipality in respect of the work or class of work. O. Reg. 799/94, s. 4(3); O. Reg. 75/97, s. 1(2).

(4) The treasurer shall not include in the update under subsection (2) or the calculation under subsection (3) any amounts payable by the municipality for the following categories of long-term debt or financial obligation:

1. Debt or financial obligation for which the Government of Ontario has agreed to pay to the municipality the amounts required by the municipality to repay the principal and interest of the debt or to meet the financial obligation.
2. Debt under the Tile Drainage Act or the Shoreline Property Assistance Act.
3. Debt or financial obligation in respect of electrical, telephone and gas service provided by the municipality for which revenues are received by the municipality.
4. Debt with respect to the downtown revitalization loan program.

O. Reg. 799/94, s. 4(4).

(5) The treasurer is not required to include in the update under subsection (2) or the calculation under subsection (3) any amounts recognized by the treasurer as current expenditures that are, or are payable under, any of the following:

1. Lease agreements.
2. Premium notes given for fire insurance.
3. Arrangements to provide pensions under paragraph 46 of section 207 of the Act.
4. Grants for retirement allowances under section 98 of the Act.
5. Agreements for fire protection under paragraph 1 of section 207 of the Act.
6. Agreements for area fire protection under clause (c) of paragraph 31 of section 210 of the Act.
7. Agreements under the Police Services Act respecting policing of the whole or any part of a municipality by the Ontario Provincial Police.
8. Agreements for sharing the cost of services of officers and employees of municipalities or local boards.
9. Agreements respecting maintenance and repair of boundary roads under section 271 of the Act.
10. Agreements respecting homes under the Homes for the Aged and Rest Homes Act.
11. Agreements respecting water supply under paragraph 2 of section 207 of the Act.
12. Agreements respecting the management and operation of systems and services under paragraph 5 of section 207 of the Act.
13. Agreements for watering or oiling highways under paragraph 7 of section 207 of the Act.
14. Agreements respecting bus franchises under paragraph 103 of section 210 of the Act.
15. Agreements for furnishing public bus transportation under paragraph 104 of section 210 of the Act.
16. Agreements for the purchase of electricity by the municipality or a local board of the municipality where the electricity to be purchased is not primarily for the consumption of the municipality or a local board of the municipality.
17. Agreements respecting matters of employment of officers and employees of the municipality or a local board of the municipality.
18. Agreements respecting regional economic development under paragraph 59 of section 207 of the Act.

19. Agreements for insurance and reciprocal contracts of indemnity or inter-insurance providing insurance and protection under paragraph 3, 50 or 51 of section 207 of the Act, section 252 of the Act or section 14 of the Municipal Conflict of Interest Act.

O. Reg. 799/94, s. 4(5); O. Reg. 75/97, s. 1(3); O. Reg. 155/99, s. 1.

(6) The council of a regional, metropolitan or district municipality or the County of Oxford which borrows money or issues debentures for the exclusive purpose of one of its area municipalities is not required to have its treasurer update its debt and financial obligation limit in respect of the borrowing or issuance.

(7) The council of a county which borrows money or issues debentures for the exclusive purpose of a town, not being a separated town, a village or a township is not required to have its treasurer update its debt and financial obligation limit in respect of the borrowing or issuance.

(8) The council of a municipality authorizing the issue or sale of debentures for a school board under section 123 of the Municipal Act is not required to have its treasurer update its debt and financial obligation limit in respect of the authorization.

(9) The council of a municipality authorizing the issue of debentures under section 124 of the Municipal Act is not required to have its treasurer update its debt and financial obligation limit for those debentures to the extent they are issued in respect of money raised for another municipality.

(10) If a council does not require the treasurer to calculate an updated limit under subsection (6), (7), (8) or (9), the treasurer shall not include any amount in respect of the borrowing, issuance or authorization in an update under subsection (2) or a calculation under subsection (3). O. Reg. 799/94, s. 4(6-10).

(11) If the amount calculated under subsection (3) exceeds the amount updated under subsection (2), the council must obtain the approval of the Ontario Municipal Board before authorizing the work or class of work. O. Reg. 799/94, s. 4(11); O. Reg. 75/97, s. 1(4).

5. (1) The Ministry shall calculate a transitional debt and financial obligation limit for a municipality in respect of any fiscal year in which the following conditions are met:

1. The municipality has been erected, incorporated or created by statute or has had a boundary alteration within the past five years.
2. The financial information necessary for the Ministry to determine a debt and financial obligation for the municipality under section 3 is not available.

(2) Despite sections 1 and 3, the Ministry may determine a transitional debt limit by estimating the revenue fund revenues for the year and by using relevant financial information obtained from any municipality or from any fiscal year.

(3) Despite section 4, the treasurer may update a transitional debt limit using relevant financial information from any fiscal year.

6. Ontario Regulations 710/92, 441/93 and 170/94 are revoked.

7. This Regulation comes into force on January 1, 1995.

APPENDIX D

RESERVES, RESERVE FUNDS, ALLOWANCES, TRUST FUNDS AND OTHER SPECIAL FUNDS, MINISTRY OF MUNICIPAL AFFAIRS AND HOUSING

This text is an unofficial version of extracts from Ontario legislation or regulations (updated to October, 1999) included for the purpose of convenience only. For accurate and more complete reference recourse should be had to the official volumes.

RESERVES, RESERVE FUNDS, ALLOWANCES, TRUST FUNDS AND OTHER SPECIAL FUNDS

INTRODUCTION

This publication reflects the reporting requirements for reserves and reserve funds under the Municipal Finance Reporting Handbook, and incorporates the revised legislative references of the Revised Statutes of Ontario, 1990, together with any subsequent amendments up to October 1999.

In the event that the Ministry requires municipalities to adopt the accounting standards as prescribed by the Public Sector Accounting Board the references to reporting requirements of the Municipal Financial Reporting Handbook that are contained in this publication will no longer apply.

The types of reserves most commonly established by municipalities, the purpose of a reserve and the accounting and reporting treatment of reserves are examined. Comments will also be made as to how reserves affect good financial management and when applicable, some alternatives to reserves are suggested.

Reserve funds, both discretionary and obligatory, are discussed along with the method of establishment and the purpose of each type of fund and its accounting and reporting treatment. Comments on how discretionary reserve funds affect good financial and cash management are also included along with some suggested alternatives to certain discretionary reserve funds.

Allowances, trust funds and other special funds are also covered in the latter sections of this publication.

The text of any legislation or regulation used in this part is an unofficial version of extracts from Ontario legislation or regulations (updated to October, 1999) included for the purpose of convenience only. For accurate and more complete reference recourse should be had to the official volumes.

RESERVES

Description

A reserve is an appropriation from net revenue at the discretion of council, after the provision for all known expenditures. It has no reference to any specific asset and does not require the physical segregation of money or assets as in the case of a reserve fund. A reserve cannot have a revenue or expense of itself, like a reserve fund.

However, a recent amendment (Subsection 162.1 (2) of the Municipal Act), sets out that a municipality may by bylaw provide that earnings derived from the investment of a reserve shall form part of that reserve.

Reserves are authorized under the provisions set out in Sections 365 (3) and 367 (3) of the Municipal Act and through similar sections contained in the special Acts establishing the Regional Municipalities, the County of Oxford Act and the District Municipality of Muskoka. A reserve may be established for a predetermined purpose and applied for that purpose at the discretion of council.

Creating a Reserve

A reserve is created by:

- including in the current estimates bylaw the amount that is to be designated as reserves during the fiscal year. This is normally set out under the heading "Provision for Reserves" or it may name the reserve itself such as "provision for a reserve for working funds."

- transferring unexpended funds identified prior to the end of the fiscal year to a reserve account. In this instance an amending by-law would be required prior to the end of the fiscal year, to segregate a specified amount from the available operating revenues.

Purpose

While reserves may be established for any municipal purpose, the most common are:

(1) Reserve for working funds.

In most municipalities accounts have to be paid before taxes, grants and other revenues become available, including revenues still to be collected for the previous year.

A municipality can obtain a short-term loan to meet this need, but borrowing incurs interest charges. In order to reduce, and, if possible avoid short-term borrowing, a working fund reserve is one financial management technique that can be helpful. It is also a cash management device to enhance cash flow.

(2) Reserve for contingencies

Such a reserve is established in anticipation of unknown expenditures or liabilities such as damage claims, municipalities. If a reserve for contingencies is not created it could have a significant effect on the future tax levy of the municipality should the liability actually materialize.

(3) Reserve for equipment replacement

Major items of equipment such as graders and snow-plows often have to be replaced on a regular basis. In a small municipality such a reserve eliminates the need to levy for the full cost of the equipment in the year of acquisition. This avoids the resulting fluctuation in the tax levy from year to year or the issuance of long-term debt.

Periodic Review of Reserves

It is suggested that the treasurer and council should periodically review the municipality's policy governing reserves. While the use of reserves is one way of maintaining a municipality's sound financial position, there are other methods of ensuring this than through the use of reserves. As examples consider the following:

- A reserve for working funds is established primarily to meet the cash requirements of the municipality prior to the collection of current revenue. Through the introduction of realistic instalment dates and an interim tax levy early in the year, the resulting cash flow improvement may minimize the need for this reserve. This elimination or reduction would then become a source of revenue in the year which the reduction takes place.

- Reserves for contingencies are provided for unusual or extraordinary expenditures such as damage claims. This reserve should be reviewed in conjunction with the municipality's insurance coverage concerning the possible settlements of these claims. A reserve for contingencies should only be maintained on the basis of sound, prudent, conservative fiscal management and not as a vague eventuality.

- Reserves for equipment replacement have been established by a number of municipalities. This type of reserve provides a smooth transition for replacement of costly vehicles and equipment.

It must be emphasized that a municipality should not reduce a reserve without sufficient financial evidence to support it. Reserves should be supported by evidence indicating the extent of the reserves required. If there is any doubt as to whether or not reserves are too high, or are no longer required, the treasurer should contact his or her auditor or the local office the Municipal Services Offices of this Ministry. A well-thought-out policy in the establishment and maintenance of reserves is still one of the keys to a sound financial structure.

RESERVE FUNDS

A reserve fund that is funded from the revenue fund is normally established in the estimates by-law with a complementary by-law (for practical purposes) outlining its operational elements.

A reserve fund differs from a reserve in that reserve fund assets are segregated and restricted to meet the purpose of the reserve fund. There are two types of reserve funds: obligatory reserve funds and discretionary reserve funds.

Creating a Reserve Fund

Obligatory reserve funds shall be created whenever a statute requires revenue received for special purposes to be segregated from the general revenues of the municipality. Examples include:

- currency exchange premiums received on debentures expressed in a foreign currency as set out under Subsection 146 (6) of the Municipal Act
- contributions received in consideration of expenses incurred or to be incurred as the result of a proposed subdivision as set out under Subsection 164(2) of the Municipal Act;
- "surplus" parking revenues under Clause (d) of Section 207 paragraph 56 of the Municipal Act;
- moneys received from special charges to provide additional sewer or water supply as set out under Subsection 218(3) of the Municipal Act;
- moneys received in lieu of land for park purposes as set out under Subsection 42(6) and (15) of the Planning Act;
- moneys received in lieu of land for park purposes under a subdivision agreement as set out under Subsection 51.1(5) of the Planning Act;
- moneys received as development charges as set out under Sections 33 to 37 of the Development Charges Act;

Discretionary reserve funds are created under Section 163(2) of the Municipal Act and under similar sections in the Regional Municipalities Act, the County of Oxford Act and the District of Muskoka Act. Discretionary reserve funds are established whenever a municipal council, local board and other entity wishes to earmark revenues to finance a future expenditure for which it has the authority to spend money, and physically set aside a certain portion of any year's revenues so that the funds are available as required. It is suggested that municipalities, local boards or other entities create new reserve funds or additional allocations to a reserve fund through the estimates process, including, defining the purpose for which the reserve fund is being created.

Local Boards and other entities

Section 163 (2) provides that a local board or other entity may in each year provide in its estimates for the establishment of a reserve fund for any purpose for which it has authority to expend funds. However, Section 163 (2.1) states " if the approval of a council is required by law for a capital expenditure or the issue of debentures by or on behalf of a local board, the local board must obtain the approval of council before providing for a reserve fund for those purposes in its estimates."

Purpose

Obligatory reserve funds are to be used solely for the purpose prescribed for them by Statute.

Discretionary reserve funds may be used for a number of different purposes. Some examples of these are:

- future expenditures for land acquisition;
- new buildings and other capital projects;
- vehicle self insurance;
- industrial promotion;
- future sick leave commitments, and,

There are two major advantages to discretionary reserve funds:

> Similar to a reserve, they help to stabilize the general municipal tax levy. In a year when a large amount of revenue is required to finance capital projects, a previously established discretionary reserve fund can enable a municipality to spend money without affecting the general municipal levy or the need to issue debentures.
>
> The assets of the reserve fund can be invested to earn income, thus helping to reduce the amount of money to be set aside.

It is highly desirable that the use of discretionary reserve funds should be kept as flexible as possible. Flexibility is partially achieved by keeping the words of the by-law general rather than particular; for example, a definition of the intended use could be "recreational purposes" rather than "swimming pool".

Flexibility is also provided under Subsection 163(4) of the Municipal Act which reads as follows:

> "The council may by by-law provide that the moneys raised for a reserve fund established under subsection (1) may be expended, pledged or applied to a purpose other than that for which the fund was established."

Management of Reserve Funds

A number of statutory restrictions apply to the management of the assets of any Reserve Fund. Subsection 163 (2.2) of the Municipal Act requires that the money raised for a reserve fund shall be placed in a special account. However Subsection 163(3) allows for the establishment of a consolidated account, but requires that the consolidated account shall be kept so as to allow the balance applicable to each individual reserve fund to be determined.

Section 163 (2.2) provides that reserve funds may be invested only in the following securities:

1. In the case of a municipality or local board, the securities in which the municipality is permitted to invest under Section 167.

2. In the case of any other entity, the securities or classes of securities that are prescribed.

Section 167 (4) of the Municipal Act allows a municipality to combine money held in the general fund, the capital fund and reserve fund for investment purposes.

Section 167(5) requires that the earnings from the combined investments shall be credited to the separate funds in proportion to the amount invested from those funds.

Review of Reserve Fund Policies

As stated earlier in this bulletin, discretionary reserve funds may be established for any purpose for which council has the authority to spend, and if handled in a responsible manner are useful tools for good financial management.

There are, however, circumstances where a reserve fund is not the most appropriate financial management technique that can be employed.

The conditions under which it may be appropriate for a council to establish discretionary reserve funds are:

- the council wishes to raise an amount from current revenue to finance future expenditures; and,
- this current revenue is to be set aside from the general operations of the municipality to ensure that it will not be used for any other purpose and be available when it is needed.

Where the two conditions referred to above do not appear to apply there are other techniques available. Two of these are:

- establishing a reserve under Sections 365 (3) or 367(3) of the Municipal Act and financing it by a provision from current revenues; or,
- earmarking some amount of current revenue as a reserve for capital purposes.

By so earmarking the revenue, the amount appears as an appropriation to reserves on the "Consolidated Statement of Operations". Any balance that remains unspent will be included as "Fund Balances at the end of the year – Reserves" on the "Consolidated

Balance Sheet". Also, included in the "Notes to the Financial Statements" should be a reference to the reserve for capital purposes in the note analysing the reserves and reserve funds.

By council limiting the conditions under which a discretionary reserve fund can be established, the following benefits may be achieved:

- the elimination of some separate bank accounts that may be required under the reserve fund legislation;
- money set up in reserves remains available for use in financing the day to day operations of the municipality;
- the number of accounting entries caused by inter-fund transfers are reduced; and,
- preparation of the working papers necessary to consolidate reserve funds for the financial statement presentation is simplified.

REPORTING TREATMENT FOR RESERVES AND RESERVE FUNDS

In accordance with principles 2009 and 2010 of the Municipal Financial Reporting Handbook, reserves and reserve funds are to be reported as follows:

- The creation or increase of a reserve should only be reported as appropriations to reserves on the Consolidated Statement of Operations and not as an expenditure.
- The decrease of a reserve should only be reported as appropriations from reserves on the Consolidated Statement of Operations. The incurrence of the actual expenditure for which the reserve was set up should be reported as a expenditure for current or capital operations on the statement at that time.
- Reserves and reserve funds should be shown on the Consolidated Balance Sheet as part of municipal equity.
- Revenues and expenditures of reserve funds, other than transfers to or from other funds, should be reported on the Consolidated Statement of Operations at the time they actually occur as sources of financing of applications (expenditures).

- It is only the net of all increases and decreases that are to be reported on the Consolidated Statement of Operations as net appropriations to or from reserves or reserve funds.

"Net appropriations" represents the difference between the total opening and the total closing balances of the individual reserves and reserve funds and will only appear on one side of the Consolidated Statement of Operations.

- Changes in reserves and reserve funds during the period, together with a list of the individual reserves and reserve funds with comparative figures and separated between obligatory and discretionary, should be disclosed by way of a note to the financial statements with specific reference made on the financial statements to the note.

ALLOWANCES

Description

An allowance differs from a reserve or a reserve fund. As an accounting matter, an allowance may be created to provide for an expected loss or reduction in the value of an asset so as to reduce the reported value of the asset to one which reflects its estimated realizable value. One of the difficulties is to determine an appropriate amount to establish for the allowance.

Creating an Allowance

An allowance is created by reporting a current expenditure under the appropriate function on the Consolidated Statement of Operations. (Generally charged against the General Government function.)

Purpose

The most common examples of allowances are:

- Allowance as an accounting matter for uncollectible taxes, used to provide for an estimated loss on the collection of unpaid taxes. (This reporting matter differs from any decision or direction made by council as to uncollectible taxes to be struck from the role, under section 441 of the Municipal Act). The calculation of this allowance can be determined as follows:
  - by a review of assessment appeals outstanding and the probability of the outcome of such appeals and,
  - by an analysis of the classes of taxes outstanding, for example, residential and farm taxes, industrial and commercial taxes and business taxes in conjunction with a historical review of previous years' tax write-offs.

The amount set up as an allowance should be only the municipal share of the taxes outstanding and determined to be uncollectible. The amounts to be recovered from the upper tier (for example, county or region) and from school boards are not to be included. These amounts will be set up as accounts receivable if and when the anticipated uncollectible taxes become a reality.

An allowance for uncollectible taxes may not be required for properties that are registered under the Municipal Tax Sales Act, 1984, as the full cancellation price should be recovered when the property is either sold or redeemed.

- Allowance for doubtful accounts, used to provide for an estimated loss on the collection of unpaid receivables. This can be determined through the use of an aging schedule of all accounts receivable and determining what accounts may not be forthcoming.

To ascertain a bad debt loss experience rating, a municipality should take into account special situations such as economic factors and business conditions.

Reporting Treatment

Provisions for allowances are generally reported under the current expenditure function – General Government, on the Consolidated Statement of Operations. When the loss for which the allowance was created occurs, it is charged directly against the allowance. When the level of the allowance exceeds the amount considered necessary, the reduction is reported as "Sources of financing – Other" on the Consolidated Statement of Operations. Because this allowance is deducted from the book value of the asset to which it relates, only the net asset is reported on the Consolidated Balance Sheet.

SPECIAL FUNDS (INCLUDING TRUST FUNDS)

Description and Purposes

A special fund arrangement may exist where money, property (or other valuables) are held by a municipality or local board for the benefit of another.

The most common special funds other than reserve funds are trust funds and funds to pay future liabilities, such as Sinking Funds or Debt Retirement Funds administered by the municipality.

A special fund may be used by a municipality or local board to segregate and administer assets under the specific terms of a statute or trust indenture. There might be restrictions placed on trust fund assets regarding the use of the capital in the fund. In some cases, the capital cannot be used, although the income earned is available for a specific purpose.

Some examples of special funds (which may or may not be trust funds) are:

- Cemetery care and maintenance funds,
- Funds held by the administrator on behalf of residents of a Home for the Aged,
- Deposits by a subdivider to guarantee installation of services,
- Deposits by a contractor to guarantee the performance of a contract,
- Endowment funds for payment of scholarships,

Of the special or trust fund examples listed above only the cemetery care and maintenance fund are specifically commented on here.

CEMETERY CARE AND MAINTENANCE FUNDS AND PRE-NEED ASSURANCE FUND

The Cemeteries Act (revised) under the Section 35 requires a portion of the proceeds from the sale of a burial plot to be set aside to provide for care and maintenance. In the case of a municipal cemetery, this portion is deposited with the Municipality, or with an independent trustee, to be invested and held. The income is paid over to the cemetery owner for the maintenance of the cemetery.

Similarly, Section 36 requires the payment into a Pre-Need Assurance Fund of all monies received for Pre-Need supplies or services until a portion of the contract in respect of which the money was paid is completed. A Municipality may act as trustee of a Pre-Need Assurance Fund.

Reporting Treatment

The transactions and fund balances for trust funds are reported on the Trust Funds Statement of Continuity and related Balance Sheet.

For trust funds such as endowment funds and cemetery care and maintenance funds there is often a legal requirement to report capital and income portions of the fund balance separately.

OTHER SPECIAL FUNDS

Sinking funds and the Ontario Clean Water Agency debt retirement funds are the most common examples of other special funds to pay future liabilities.

A municipality which has sinking fund debentures outstanding is required to accumulate a sinking fund by setting aside a predetermined amount each year for principal repayment, which is invested in types of securities specified in the Municipal Act. A separate sinking fund may be established for each sinking fund issue. The amount of money which must be raised and paid into a sinking fund must be stated in each year by the municipal treasurer. No moneys in the fund may be diverted from the sinking fund other than to pay off the sinking fund debentures for which the fund was established (except possibly in a rare case where adequate surplus exists - see below).

When the municipal debenture issue falls due, the sinking fund investments are converted into cash and the proceeds are used for the redemption of the matured debentures. Once adequate funding is available to redeem the debentures the future surpluses may be transferred with the approval of the municipal council to the general funds of the municipality.

APPENDIX A

LEGISLATION RESPECTING RESERVE FUNDS (Some 'obligatory')

The text below is an unofficial version of extracts from Ontario legislation (updated to October, 1999) included for the purpose of convenience only. For accurate and more complete reference recourse should be had to the official volumes (including any applicable regulations).

Premiums Received in Foreign Currency Debentures

The Municipal Act

Subsection 146(6)

Premium to be set aside in reserve fund

(6) Every money by-law passed under this section may provide that any portion of the premium which may be received on the currency in which the debentures are payable that is not required to pay the cost of the work authorized under the by-law and incidental charges shall be set aside in a reserve fund to be used to pay the premium on the annual payments of principal and interest on the debentures.

Subdivision Contributions

The Municipal Act

Section 164

Contributions re expenses incurred by corporation re proposed subdivision of land

164. (1) Where a contribution is received by a municipal corporation in consideration of the expense incurred or to be incurred by the corporation as a result of a proposed subdivision of land, such contribution shall be used only to meet expenditures for work done within the subdivision or for the benefit or use of the occupiers or subsequent occupiers of the land within the subdivision or to meet expenditures incurred wholly or in part by reason of the subdivision of such land and, where a contribution is made for a specific purpose, it may be used only to meet expenditures for such purpose.

Special account

(2) The contributions shall be paid into a special account, and subsections 163(2.2), (2.3) and (3) apply with necessary modifications.

Use for other purposes

(3) Despite subsection (1), if any of the contributions referred to in subsection (1) are not required or likely to be required for the purposes mentioned in subsection (1), they may be spent for some other purpose.

Municipal Parking Lots

Municipal Act

Section 207, paragraph 56 **[part including clause (d)]**

Municipal parking lots

56. For acquiring, establishing, laying out and improving land, buildings and structures where vehicles may be parked, and for erecting buildings or structures for or in connection with the parking of vehicles in, on or under any land vested for any purpose in a municipality, and for leasing such land, buildings or structures, and for regulating, supervising and governing the parking of vehicles therein or thereon.

Definition of vehicle

(a) A by-law under this paragraph may define vehicle for the purposes of the by-law.

Application

(b) Land acquired or established for the parking of vehicles under this paragraph and buildings and structures acquired or erected under this paragraph shall be deemed to be a highway for the purposes of paragraph 8 of subsection 314(1) and that said paragraph applies to such land, buildings and structures.

Entrances and exits from underground parking facilities

(c) A by-law under this paragraph may set aside and designate on any land vested for any purpose in a municipality entrances and exits to or from any underground parking facilities for the use of persons or vehicles, provided no such entrances or exits shall be set aside on a connecting link or extension of the King's Highway without the approval of the Ministry of Transportation.

Reserve fund

(d) Where a municipality established a parking lot or lots or erects buildings or structures therein, thereon or thereunder for such purposes or constructs underground parking facilities in the municipality at the expense of all the ratepayers of the municipality, the municipality shall establish a reserve fund and deposit therein the net revenue derived from the operation of all parking facilities operated by or on behalf of the municipality or leased by or on behalf of the municipality for parking purposes, including parking meters on highways.

Idem

(e) Such reserve fund shall be applied,

(i) firstly, for the payment of interest and principal falling due in each year in respect of any debentures issued for the purposes of this paragraph, and

(ii) secondly, for the acquisition, establishment, laying out or improvement of additional parking lots or facilities, and

(iii) thirdly, for such other purposes as the council may approve. ...

Special Charges to provide additional sewer or water capacity

The Municipal Act

Section 218 **[part including subsection (3)]**

Special charges to provide additional sewer or water supply capacity

218. (1) With the approval of the Municipal Board, councils of local municipalities may, by by-law, define the class or classes of buildings to be erected or enlarged after the effective date of the by-law that impose or may impose a heavy load on the sewer system or water system, or both, by reason of which expenditures are or may be required to provide additional sanitary or storm sewer or water supply capacity that in the opinion of a council would not otherwise be required, and may impose upon the owners of such buildings a special charge or charges over and above all other rates and charges to pay for all or part of the cost of providing the additional capacity.

Charges to refer to specific works

(2) The special charge or charges under any by-law shall refer specifically to sewage works or water works as defined in section 221, or to both, as the case may be.

Application of proceeds

(3) The proceeds of the charge or charges authorized by any such by-law shall be deemed to be a reserve fund established under section 163. ....

Revenue in lieu of parkland

The Planning Act

Section 42 **[part - subsections (15) and (16)]**

Special account

(15) All money received by the municipality under subsections (6) and (14) and all money received on the sale of land under subsection (5), less any amount spent by the municipality out of its general funds in respect of the land, shall be paid into a special account and spent only for the acquisition of land to be used for park or other public recreational purposes, including the erection or repair of buildings and the acquisition of machinery for park or other public recreational purposes.

Investments

(16) The money in the special account may be invested in securities in which the municipality is permitted to invest under section 167 of the Municipal Act, and the earnings derived from the investment of the money shall be paid into the special account, and the auditor in the auditor's annual report shall report on the activities and status of the account.

Revenue in lieu of land under a subdivision agreement

The Planning Act

Section 51.1 **[part - subsection (5)]**

Application

(5) Subsections 42(2), (5) and (12) to (16) apply with necessary modifications to a conveyance of land or a payment of money under this section.

Revenue received as development charges

The Development Charges Act, 1997

The new Development Charges Act 1997 contains provisions regarding reserve funds and special accounts as follows:

- Sections 33-37, regarding Reserve Funds and the Use of Development Charges
- Section 54, regarding money received and uses of money received with respect to Front-ending Agreements
- Section 63, regarding Transitional Rules for reserve funds under the old DCA.

Appendix B

Legislation Re Discretionary Reserves

And Reserve Funds

The text below is an unofficial version of extracts from Ontario legislation (updated to October, 1999) included for the purpose of convenience only. For accurate and more complete reference recourse should be had to the official volumes (including any applicable regulations).

The Municipal Act

Reserves

Section 365 **[part including subsection 365(3)]**

365. (1) The council of an upper-tier municipality shall in each year prepare and adopt estimates of all sums required during the year for the purposes of the upper-tier municipality including amounts sufficient to pay all debts of the upper-tier municipality falling due within the year, amounts required to be raised for sinking funds, amounts in respect of debenture debt of lower-tier municipalities for the payment of which the upper-tier municipality is liable and amounts required by law to be provided by the upper-tier municipality for any of its local boards, excluding school boards.

Detail and form

(2) The estimates shall set out the estimated revenues and expenditures in such detail and form as the Minister may require.

Allowance

(3) In preparing the estimates, the council of the upper-tier municipality shall make due allowance for a surplus of any previous year that will be available during the

current year and shall provide for any operating deficit of any previous year and for uncollectible taxes and may provide for taxes that it is estimated will not be collected during the year **and for such reserves as the council of the upper-tier municipality considers necessary**. .....

(Bold added for emphasis.)

Section 367 **[part including subsection (3)]**

Yearly estimates, local municipalities

367. (1) The council of a local municipality shall in each year prepare and adopt estimates of all sums required during the year for the purposes of the municipality including amounts sufficient to pay all debts of the municipality falling due within the year, amounts required to be raised for sinking funds and amounts required for any board, commission or other body.

Detail and form

(2) The estimates shall set out the estimated revenues and expenditures in such detail and form as the Minister may require.

Allowance

(3) In preparing the estimates, the council of the local municipality shall make due allowance for a surplus of any previous year that will be available during the current year and shall provide for any operating deficit of any previous year and for the cost of collection, abatement of and discount on taxes and for uncollectible taxes and may provide for taxes that it is estimated will not be collected during the year **and for such reserves as the council of the municipality considers necessary. ......**

(Bold added for emphasis.)

Reserve Funds

Section 163

Definitions

163. (1) In this section,

"local board" means a local board as defined in the Municipal Affairs Act;

"municipality" means a county, city, town, village or township;

"other entity" means a board, commission, body or local authority established or exercising any power or authority with respect to municipal affairs under any general or special Act in an unorganized township or in unsurveyed territory.

Reserve fund

(2) Every municipality, local board and other entity may in each year provide in its estimates for the establishment or maintenance of a reserve fund for any purpose for which it has authority to expend funds.

Approval of council

(2.1) If the approval of a council is required by law for a capital expenditure or the issue of debentures by or on behalf of a local board, the local board must obtain the approval of the council before providing for a reserve fund for those purposes in its estimates.

Investment

(2.2) The money raised for a reserve fund shall be paid into a special account, and may be invested only in the following securities:

1. In the case of a municipality or local board, the securities in which the municipality is permitted to invest under section 167.

2. In the case of any other entity, the securities or classes of securities that are prescribed.

Same

(2.3) The earnings derived from investment of the reserve fund form part of it.

Consolidated account

(3) The council may by by-law provide that, instead of a separate account being kept for each reserve fund, a consolidated account may be kept in which there may be deposited the money raised for all reserve funds established under this section but which consolidated account shall be so kept that it will be possible to determine therefrom the true state of each reserve fund.

Expenditure of reserve fund money

(4) The council may by by-law provide that the money raised for a reserve fund established under subsection (1) may be spent, pledged or applied to a purpose other than that for which the fund was established.

Auditor to report on reserve funds

(5) The auditor in the annual report shall report on the activities and position of each reserve fund established under subsection (2).

Regulations

(6) The Lieutenant Governor in Council may make regulations prescribing securities or classes of securities for the purposes of paragraph 2 of subsection (2.2).

Same

(7) A regulation made under subsection (6) may be general or particular in its application.

Investments

The Municipal Act

Definition

167. (1) In this section,

"municipality" includes a metropolitan, regional or district municipality and the County of Oxford.

Investment, advance to capital account

(2) If a municipality has money that it does not require immediately, it may,

(a) subject to the prescribed rules, invest the money in prescribed securities; or

(b) advance the money to its capital account as interim financing of capital undertakings of the municipality.

Repayment with interest

(3) An investment or advance under subsection (2) shall be made repayable on or before the day on which the municipality requires the money; any interest earned shall be credited to the fund from which the money was invested or advanced.

Combined investments

(4) A municipality may combine money held in the general fund, the capital fund and the reserve fund and deal with the money in accordance with subsection (2).

Allocation

(5) Earnings from the combined investments shall be credited to each separate fund in proportion to the amount invested from that fund.

Regulations

(6) The Lieutenant Governor in Council may make regulations

(a) prescribing rules for the purposes of clause (2)(a);

(b) prescribing securities or classes of them for the purposes of clause (2)(a);

(c) providing that a municipality does not have power to invest under this section in specified securities or classes of securities, and specifying the securities and classes.

Same

(7) A regulation made under subsection (6) may be general or particular in its application.

December 15, 1999

APPENDIX E

A SAMPLE OF 2000 FINANCIAL INFORMATION RETURN SCHEDULES
(proposed format for information only)

SOURCES OF CAPITAL FUND FINANCING AND EXPENDITURES

2000FIR

Schedule 42

for the year ended December 31, 2000

Mun ID MMAH Municipality

		Sources of capital fund financing						
		Contributions from own funds		Capital grants		Other municipalities	Other financing	Capital expenditures
		Revenue fund	Reserves, reserve funds and deferred revenue	Ontario	Canada			
		1 $	2 $	3 $	4 $	5 $	6 $	7 $
0299	**General government**							
0410	**Protection services**							
0420	Fire							
0430	Police							
0440	Conservation authority							
0450	Protective inspection and control							
0460	Emergency measures							
0498	• Please specify							
0499	**Subtotal**							
	Transportation services							
0610	Roadways (incl. winter control)							
0620	Transit							
0630	Parking							
0640	Street lighting							
0650	Air transportation							
0698	• Please specify							
0699	**Subtotal**							
	Environmental services							
0810	Sanitary sewer system							
0820	Storm sewer system							
0830	Waterworks system							
0840	Waste collection							
0850	Waste disposal							
0860	Recycling							
0898	• Please specify							
0899	**Subtotal**							
	Health services							
1010	Public health services							
1020	Hospitals							
1030	Ambulance services							
1040	Cemeteries							
1098	• Please specify							
1099	**Subtotal**							
	Social and family services							
1210	General assistance							
1220	Assistance to aged persons							
1230	Childcare							
1298	• Please specify							
1299	**Subtotal**							
1499	**Social housing**							
	Recreation and cultural services							
1610	Parks							
1620	Recreation programs							
1630	Recreation facilities							
1640	Libraries							
1650	Cultural services							
1698	• Please specify							
1699	**Subtotal**							
	Planning and development							
1810	Planning and zoning							
1820	Commercial and industrial							
1830	Residential development							
1840	Agriculture and reforestation							
1850	Tile drainage/shoreline assistance							
1898	• Please specify							
1899	**Subtotal**							
3099	Electricity							
3299	Gas							
3499	Telephone							
9910	**TOTAL**							

CAPITAL FUND OPERATIONS

2000FIR

Schedule 40

for the year ended December 31, 2000

Mun ID MMAH Municipality

	SOURCES of CAPITAL FUND FINANCING	
	Capital Fund Revenues	
		1
	Long term liabilities incurred	$
0205	Canada Mortgage and Housing Corporation	
0210	Ontario Financing Authority	
0215	Commercial Area Improvement Program	
0220	Other Ontario housing programs	
0225	Ontario Clean Water Agency	
0230	Tile drainage and shoreline property assistance programs	
0235	Serial debentures	
0240	Sinking fund debentures	
0245	Long term bank loans	
0250	Long term reserve fund loans	
0298	- Please specify	
0299	**Subtotal**	
	Grants and loan forgiveness:	
0410	Ontario	
0420	Canada	
0499	**Subtotal**	
0699	**Other municipalities - Grants and fees**	
	Other revenue:	
0810	Prepaid special charges	
0820	Proceeds from sale of land	
0830	Proceeds from sale of hydro utilities	
0840	Proceeds from sale of other capital assets	
	Investment income	
0850	From own funds	
0860	From other	
0870	Donations	
0897	- Please specify	
0898	- Please specify	
0899	**Subtotal**	
9910	**TOTAL Capital Fund Revenues**	
	Transfers From Own Funds To Capital Fund	
2010	Contributions from revenue fund	
2020	Contribution from reserves, reserve funds and deferred revenue	
9920	**TOTAL Transfers from own funds to capital fund**	
9930	**TOTAL Sources of capital financing**	
	APPLICATIONS of CAPITAL FUND FINANCING	
3099	**Capital expenditures**	
	Transfers of proceeds from long term liabilities to:	
3210	Other municipalities	
3220	Unconsolidated local boards	
3230	Individuals	
3299	**Subtotal**	
	Transfers from capital fund to own funds	
3410	Transfers to revenue fund	
3420	Transfers to reserves and reserve funds	
3499	**Subtotal**	
9940	**TOTAL Applications of capital financing**	

(Cont'd)

CAPITAL FUND OPERATIONS

Schedule 40

for the year ended December 31, 2000

2000FIR

Mun ID	MMAH	Municipality

S 5 - Page 9

	CONTINUITY of CAPITAL FUND OPERATIONS		$ 1
5010	Capital fund balance, beginning of year		
5020	PLUS: Total Sources of Capital Financing		
5030	LESS: Total Applications of Capital Financing		
5040	Capital fund balance, end of year		
	Capital fund balance, end of year, reported in line 5040 is analyzed as follows:		$
5200	Unexpended capital financing		
5400	LESS: Unfinanced capital outlay		
5410	To be recovered from:	Taxation or user charges within term of council	
5420		Proceeds from long term liabilities	
5430		Transfers from reserves and reserve funds	
5498		• Please specify	
9950		**Capital fund balance, end of year**	
	Total of line 3099 includes:		$
6010	Short term interest costs		

LONG TERM LIABILITIES AND COMMITMENTS

Schedule 64

for the year ended December 31, 2000

Mun ID MMAH Municipality

	1. Debt burden of the municipality	1 $
	All outstanding debt issued by the municipality, predecessor municipalities and consolidated entities	
0210	• To Ontario and agencies	
0220	• To Canada and agencies	
0230	• To others	
0299	Subtotal	
0499	PLUS: All debt assumed by the municipality from others	
	LESS: All debt assumed by others	
0610	• Ontario	
0620	• School boards	
0630	• Other municipalities	
0699	Subtotal	
	LESS: Ontario Clean Water Agency debt retirement funds	
0810	• sewer	
0820	• water	
0899	Subtotal	
	LESS: Own sinking funds (actual balances)	
1010	• general municipal	
1020	• enterprises and others	
1099	Subtotal	
9910	TOTAL Debt burden of the municipality	

	2. Debt burden of the municipality - Analysed by debt instrument	$
1210	Sinking fund debentures	
1220	Installment (serial) debentures	
1230	Long term bank loans	
1240	Lease purchase agreements	
1250	Mortgages	
1260	Ontario Clean Water Agency	
1270	Long term reserve fund loans	
1298	• Please specify	
9920	TOTAL Debt burden of the municipality	

	3. Debt burden of the municipality - Analysed by function		$
1405	General government		
1410	Protection services		
1415	Transportation services:	Roadways	
1420		Transit	
1425	Environmental services:	Sanitary sewer system	
1430		Storm sewer system	
1435		Waterworks system	
1440		Waste collection	
1445		Waste disposal	
1450	Health services		
1455	Social and family services		
1460	Social housing		
1465	Recreation and cultural services:	Parks	
1470		Recreation facilities	
1475		Libraries	
1480	Planning and development		
1485	Electricity		
1486	Gas		
1487	Telephone		
1490	Other long term liabilities		
9930	TOTAL Debt burden of the municipality		

(Cont'd)

LONG TERM LIABILITIES AND COMMITMENTS

2000FIR

Schedule 64

for the year ended December 31, 2000

Mun ID	MMAH	Municipality

4. Debt payable in foreign currencies (net of sinking fund holdings)

			$
1610	U.S. dollars	• Canadian dollar equivalent included in line 9910 above	
1620		• par value in 'U.S. dollars'	
1630	Other currency	• Canadian dollar equivalent included in line 9910 above	
1640		• par value in: • Please specify currency	

5. Interest earned on sinking funds and on debt retirement funds during the year

		$
1810	Own funds	
	Ontario Clean Water Agency	
1820	Sewer	
1830	Water	

6. Details of sinking fund balance

		$
2010	Value of own sinking fund debentures issued and outstanding at year end	
2200	Balance of own sinking funds at year end	
2210	• Total contributions to own sinking funds	
2220	• Total income earned from investments of sinking funds' monies	
2230	Estimated total future contributions from this municipality required to meet obligations in line 2010 above	
2240	Estimated total future income earned from investments in lines 2200 and 2230 above	

7. Long term commitments at year end

		$
2410	hospital support	
2420	university support	
2430	leases and other agreements	
2440	capital equipment, land acquisition	
2496	• Please specify	
2497	• Please specify	
2498	• Please specify	
2499	TOTAL	

8. Contingent liabilities

		1	2
		Please 'X' box if value is estimated	$
2610	Pending or threatened litigation		
2620	Retroactive wage settlements		
2630	Guarantees of long term indebtedness in the name of the municipality but assumed by others		
2640	Outstanding loans guaranteed (payable over: • Specify years years)		
2698	• Please specify		
2699	TOTAL		

9. Ontario Clean Water Agency Provincial Projects

			accumulated surplus / deficit	total outstanding capital obligation	debt charges
			1 $	2 $	3 $
2810	Water projects	• for this Municipality only			
2820		• share of integrated project(s)			
2830	Sewer projects	• for this Municipality only			
2840		• share of integrated project(s)			

(Cont'd)

LONG TERM LIABILITIES AND COMMITMENTS

2000FIR

Schedule 64

for the year ended December 31, 2000

Mun ID	MMAH	Municipality	S 8 - Page 12

10. Debt Charges for the current year

		principal 1 $	interest 2 $
3010	Recovered from the consolidated revenue fund		
3020	Recovered from reserve funds		
	Recovered from unconsolidated entities:		
3030	electricity		
3040	gas		
3090	telephone		
3097	• Please specify		
3098	• Please specify		
3099	TOTAL		
	Line 3099 includes:		
3110	Lump sum (balloon) repayments of long term debt		

11. Future principal and interest payments on EXISTING debt

		Recoverable from the consolidated revenue fund		Recoverable from reserve funds		Recoverable from unconsolidated entities		Recoverable from all others	
		principal 1 $	interest 2 $	principal 3 $	interest 4 $	principal 5 $	interest 6 $	principal 7 $	interest 8 $
3210	Year 2001								
3220	Year 2002								
3230	Year 2003								
3240	Year 2004								
3250	Year 2005								
3260	Years 2006 to 2010								
3270	Years 2011 onwards								
3280	Interest to be earned on sinking funds								
3290	Downtown revitalization program								
3299	TOTAL								

12. Long term debt refinanced:

		principal 1 $	interest 2 $
3410	Repayment of Provincial Special Assistance		
3420	Other long term debt refinanced		

13. Other notes (please forward supporting schedules as required)

3610 ______________________________
3620 ______________________________
3630 ______________________________
3640 ______________________________
3650 ______________________________
3660 ______________________________
3670 ______________________________
3680 ______________________________
3690 ______________________________

CONTINUITY OF RESERVES AND RESERVE FUNDS

2000FIR

Schedule 50

for the year ended December 31, 2000

Mun ID	MMAH	Municipality

S 10 - Page 15

		Obligatory reserve funds (deferred revenue)	Discretionary reserve funds	Reserves
		1	2	3
		$	$	$
0299	**Balance, beginning of year**			
	Revenues			
0410	Contributions from revenue fund			
0420	Contributions from capital fund			
	Development Charges Act			
0610	Non-discounted services			
0620	Discounted services			
0699	**Subtotal Development Charges Act**			
0810	Lot levies			
0820	Subdivider contributions			
0830	Recreational land (the Planning Act)			
	Investment income			
0840	From own funds			
0850	From other			
0895	• Please specify			
0896	• Please specify			
0897	• Please specify			
0898	• Please specify			
9910	**TOTAL Revenues**			
	Expenditures			
1010	Transferred to capital fund			
1020	Transferred to revenue fund			
1030	Charges for long term liabilities - principal and interest			
1096	• Please specify			
1097	• Please specify			
1098	• Please specify			
9920	**TOTAL Expenditures**			
2099	**Balance, end of year**			

(Cont'd)

CONTINUITY OF RESERVES AND RESERVE FUNDS

2000FIR

Schedule 50

for the year ended December 31, 2000

Mun ID MMAH Municipality

S 10 - Page 15

		Obligatory reserve funds / Deferred revenue	Discretionary reserve funds	Reserves
	Totals in line 2099 are analysed as follows:	1	2	3
		$	$	$
5010	Working funds			
5020	Contingencies			
	Ontario Clean Water Agency fund for renewals, etc.			
5030	• Sewer			
5040	• Water			
5050	Replacement of equipment			
5060	Sick leave			
5070	Insurance			
5080	Workplace Safety and Insurance Board (WSIB)			
5090	Post-employment benefits			
	Current purposes			
5205	General government			
5210	Protection services			
5215	Transportation services • Roadways			
5220	• Transit			
5225	Environmental services • Sanitary sewer system			
5230	• Storm sewer system			
5235	• Waterworks system			
5240	• Waste collection			
5245	• Waste disposal			
5250	Health services			
5255	Social and family services			
5260	Social housing			
5265	Recreation and cultural services • Parks			
5270	• Recreation facilities			
5275	• Libraries			
5280	Planning and development			
5290	Other and unspecified			
	Capital purposes			
5405	General government			
5410	Protection services			
5415	Transportation services • Roadways			
5420	• Transit			
5425	Environmental services • Sanitary sewer system			
5430	• Storm sewer system			
5435	• Waterworks system			
5440	• Waste collection			
5445	• Waste disposal			
5450	Health services			
5455	Social and family services			
5460	Social housing			
5465	Recreation and cultural services • Parks			
5470	• Recreation facilities			
5475	• Libraries			
5480	Planning and development			
5490	Other and unspecified			
	Obligatory reserve funds / Deferred revenue:			
	Development Charges Act			
5610	• Non-discounted services			
5620	• Discounted services			
5630	Lot levies			
5640	Subdivider contributions			
5650	Recreational land (the Planning Act)			
5660	Parking revenues			
5670	Debenture repayment			
5680	Exchange rate stabilization			
5697	• Please specify			
5698	• Please specify			
9930	TOTAL			

CONSOLIDATED FINANCIAL POSITION

2000FIR

Schedule 60

for the year ended December 31, 2000

Mun ID MMAH Municipality

	Financial assets	1
		$
0299	**Cash and temporary investments**	
	Accounts receivable	
0410	Canada	
0420	Ontario	
0430	Upper-tier	
0440	Other municipalities	
0450	School boards	
0460	Other receivables	
0499	**Subtotal**	
	Taxes receivable	
0610	Current year's levies	
0620	Previous year's levies	
0630	Prior year's levies	
0640	Penalties and interest	
0680	LESS: Allowance for uncollectables	
0699	**Subtotal**	
	Other financial assets	
	Investments	
0805	Canada	
0810	Provincial	
0815	Municipal	
0820	Government business enterprises	
0825	Other	
0830	Inventories held for resale	
0835	Notes receivable	
0840	Mortgages receivable	
0845	Debt recoverable from others	
0850	Deferred taxes receivable	
0860	Other	
0899	**Subtotal**	
9910	**TOTAL Financial assets**	
	Physical assets	
1010	Inventories of materials and supplies	
9920	**TOTAL Physical assets**	
9930	**TOTAL Assets**	

	Liabilities	
	Temporary loans	$
2010	Current purposes	
2020	Capital purposes • Canada	
2030	• Ontario	
2040	• Other	
2099	**Subtotal**	
	Accounts payable and accrued liabilities	
2210	Canada	
2220	Ontario	
2230	Upper-tier	
2240	Other municipalities	
2250	School boards	
2260	Interest on debt	
2270	Trade accounts payable	
2280	Accrued Workplace Safety and Insurance Board claims	
2290	Other	
2299	**Subtotal**	
	Deferred revenue	
2410	Obligatory	
2480	Other	
2499	**Subtotal**	
	Long term liabilities	
2610	Debt issued	
2620	Debt payable to others	
2699	**Subtotal**	
	Post employment benefits	
2810	Accumulated sick leave	
2820	Accrued vacation pay	
2830	Accrued pensions payable	
2895	• Please specify	
2899	**Subtotal**	
9940	**TOTAL Liabilities**	

	Financial position	
	Fund balances	1
	Revenue fund	$
5010	General revenue	
	Special charges and special areas	
5026	• Please specify	
5027	• Please specify	
5028	• Please specify	
5029	• Please specify	
	Local boards	
5030	Transit operations	
5035	Water operations	
5040	Sewer operations	
5045	Libraries	
5050	Cemeteries	
5055	Recreation, community centres and arenas	
5060	Business Improvement Area	
5076	• Please specify	
5077	• Please specify	
5078	• Please specify	
5079	• Please specify	
5080	Equity in government business enterprises	
5099	**Subtotal**	
5299	**Capital fund balance**	
5499	**Reserves and Reserve funds**	
9950	**TOTAL Fund balances**	
	Amounts to be recovered in future years	
5810	Long term liabilities	
5820	Post employment benefits	
5899	**Subtotal**	
6099	**Net financial assets (liabilities)**	
9960	**TOTAL Liabilities and fund balances**	

APPENDIX F

OTHER PUBLICATIONS AND SOURCES OF MATERIAL ON CAPITAL BUDGETING AND CAPITAL FINANCING

Other Publications and Sources of Material on Capital Budgeting and Capital Financing

Other Related Publications:

Capital Improvement Programming - A Guide for Smaller Municipalities, GFOA, 1996.

Procedure Manual re: Municipal Financial Planning Through Capital Budgeting and Economic Analysis, AMCTO, 1990.

Review of the Regulatory Environment of Municipal Capital Borrowing, David P. Amborski, 1999.

Municipal Accounting: Basic Concepts, AMCTO, 1983.

How to Apply the Provisions of *The Local Improvement Act*, AMCTO, 1998.

Procedure Manual for *The Drainage Act*, AMCTO, 1982.

Sources of Additional Information:

Association f Municipal Managers, Clerks and Treasurers of Ontario (AMCTO)

AMCTO offers a two unit Municipal Accounting and Finance Program (MAFP) covering many issues related to capital budgeting.

Municipal Finance Officers Association (MFOA)

Government Finance Officers of America (GFOA)

Ministry of Municipal Affairs and Housing (MMAH)

- MMAH published bulletins

Intergovernmental Committee on Urban and Regional Research (ICURR)

- ICURR offers a comprehensive data base and lending library

University Libraries

World Bank Library

Credit Rating Agencies (such as Dominion Bond Rating Service (DBRS))

APPENDIX G

INSTRUCTIONS FOR CAPITAL BUDGETING APPLICATION SOFTWARE SET-UP AND USE

APPENDIX G

The diskette attached to this document contains the capital budgeting application software as well as the necessary instructions for its set-up and use. Please see the diskette label for further instructions.